MAR GREGORIOS COLLEGE
OF ARTS & SCIENCE

Block No.8, College Road, Mogappair West, Chennai – 37

Affiliated to the University of Madras
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DEPARTMENT OF COMMERCE
(CORPORATE SECRETARYSHIP)

SUBJECT NAME: CORPORATE ACCOUNTING-I

SUBJECT CODE: AY23A

SEMESTER: III

PREPARED BY: PROF.S.PRASANNA

UNIT-I Share Capital

Shares – kinds of shares - Issue of Shares – Types of Shares – Reissue of shares and Redemption of preference shares.

UNIT–II Debentures & Underwriting

Debentures – Kinds- Issue of Debentures at par – premium – Discount – Loss on issue of Debentures – Conversion of Debentures –Redemption of debentures – Sinking fund Account – Purchase and cancellation of own debentures – Cum-interest and Ex-interest quotations Underwriting of Shares – Firm underwriting – Profits prior to incorporation.

UNIT–III Final Accounts

Company Final Accounts– Preparation of Profit and loss account and balance sheet,
Managerial Remuneration.

UNIT – IV Valuation of goodwill & Shares

Valuation of goodwill & Shares – Meaning – Methods of valuation.

UNIT – V Accounting for Insurance Company

Insurance Company – Types – Final accounts of life Insurance – profit determination of life Insurance

UNIT I – ISSUE OF SHARES

1. Define a Company.

"An association of many persons who contribute money or money's worth to a common stock and employ it in some common trade or business (i.e for a common purpose) and who share the profit or loss (as the case may be) arising therefrom".

- Lord Justice Lindley.

2. What the salient features of a company?

The following are the salient features of a company:

(i) Separate Legal Entity: On the registration of a company the company is considered as a separate entity from its members. It is considered as a natural person that means it can own property, employ people, enter into contracts. Even if a single person owns all its shares the company is treated as a separate legal entity.

(ii) Limited Liability: The liability of the shareholders of the company is limited to the extent of shares that are held by the company. Under no circumstances can a shareholder be asked to pay the companies loans.

(iii) Transfer of Shares: The capital of the company is divided into smaller denominations called as shares which are transferable in manner provided by the Articles of the company.

(iv) Separate Property: It is a legal entity distinct from its members. Like any other human beings it can own, hold and dispose of property in its own name. Thus the member by selling back the shares of the company gets easy money. Shareholder does not have insurable interest in the company.

(v) Perpetual Succession: "*Men may come and men may go but I go on forever*" is the right saying about the company. The existence of the company is perpetual and is not affected by the death or insanity of a partner.

(vi) Ownership divorced from management: Merely holding the shares of the company does not entitle one to participate in the management. It is entrusted with the BOD. They are the ultimate executive authority.

(vii) Common Seal: It is the symbol of incorporation of the company. It may be any form. A signature, emblem or word and is used to certify or attest a document.

3. What is Minimum subscription?

Minimum subscription is the amount which must be raised by the company by the issue of shares to meet certain expenditure. This amount is examined by taking into account:

(a) Amount required for purchasing fixed asset.

(b) Amount required for paying preliminary expenses.

(c) Amount required for the repayment of loan.

(d) Amount required for working capital.

(e) Amount required for other purpose.

4. What is allotment of shares?

After issuing the prospectus the sale of shares sets in. shares are allotted on the minimum subscription. If the minimum subscription is not received the amount has to be returned within 10days. The directors are liable to pay interest @ 6%.

5. What is a share?

A share may be defined as one of the equal parts into which the capital of a company is divided, entitling the holder of the share to a proportion of the profits.

6. What are the various kinds of shares?

Under the companies Act 1956, as amended up to date may have three classes of shares. They are (i) Preference shares (ii)Equity shares and (iii) Shares with differential rights.

7. What is a preference share?

A preference shares enjoys preference shares. First preference shares a fixed dividend is guaranteed before any payment of dividend is made in respect of equity shares. Second they enjoy preferential right at the time of winding up of the company.

8. What is an Equity share?

Equity shares are those which carry no special rights of annual dividends and return of capital after the company goes into liquidation. Dividends on such shares are not fixed. Dividend is paid out of the residual profits of the company.

9. What are Differential shares?

Differential shares are of two types: (i) Deferred shares (ii) Shares with differential rights.

Deferred Shares: These are known as “Founders shares” or “Management shares” as these are issued to the promoters and their friends at the time of formation of the company.

Shares with differential Rights: Under the Companies (Amendment)Act, 2000 under section 2 (46A), for the issue of differential rights in accordance with the provisions of Section 86. The differential rights can be with regard to (i)Dividend (ii) Voting rights or (iii)Otherwise.

10. What is meant by allotment of shares?

On the expiry of the last date for receiving applications, a detailed list of the applicants is prepared showing the number of applications in different categories, based on the number of shares applied by them. The directors can proceed with the allotment if the following are fulfilled:

(1) The minimum subscription as stated in the prospectus is received.

(2) The prospectus or a statement in lieu of the prospectus is filed with the register of the companies in due time.

(3) Application money at least 5% of the nominal value of shares is received.

11. What is under subscription?

If the total number of shares for which applications are received is less than the number of shares issued, it is a situation of under subscription. In this case the company can proceed with the minimum subscription that has been received.

12. What is over subscription?

If the applications are received more than that are issued by the company then it is said to be over subscription. In this case the excess application money received is adjusted towards allotment and for the rejected applicants the application money is refunded.

13. What is pro-rata allotment?

Shares may be allotted proportionate to the applications received to all the applications. It may be possible to reject some applications on the basis of some criterion and for the balance applications, proportionate allotment may be made. This surplus application money of the pro-rata allottees can be adjusted towards the sum due from them for allotment and even calls, if the company’s Articles of Association provides for it.

14. What is share forfeiture?

Termination of membership and taking away of the shares of the shareholders because of default in the payment of allotment and/or call money. When shares are forfeited

(i) A shareholder ceases to be a member.

(ii) His/Her name is removed from the register of members of the company.

(iii) The forfeited shares becomes the property of the company. The amount already collected to them is a gain to the company.

15. In how many ways can the shares be issued?

When the shares are issued at exactly the face value of shares are said to be issued at Par. (Rs. 10 share issued at Rs.10)

When the shares are issued above the face value of shares it is said to be Premium. (Eg: Rs.10 share issued at Rs.11)

When the shares are issued below the face value of shares it is said to be issued at a discount. (Eg: Rs.10 share issued at Rs.9)

16. What are calls-in-arrears?

When one or more shareholders fail to pay the amount due from them towards allotment and/or calls, such dues are called “Calls in arrears”.

17. What are calls-in-advance?

When one or more shareholders pay the amount due towards call or allotment in advance to the company it is called as calls-in-advance.

Problems:

1. Vahid Ltd. Purchased the business of Rahim Bros for Rs.2,00,000 payable in fully paid shares of Rs.100 each. What entries will be made in the books of Vahid if such shares is issued at (i) Par (ii)Premium and (iii) Discount.

(i) For Par:

Bank A/C Dr. 2,00,000

To Eq. Share Capital 2,00,000

(Being Shares issued at Par)

(ii) For Premium:

Bank A/C Dr. 2,20,000

To Eq.Sh.Capital 2,00,000

To Sh. Premium A/C 20,000

(Being Shares issued at Premium)

(iii) For Discount:

Bank A/C Dr. 1,80,000

Discount A/C Dr. 20,000

To Sh.Capital A/C 2,00,000

(Being shares issued at discount)

2.Ram Ltd invited applications for 1,40,000 shares of Rs.10 each payable Rs.2 on application Rs.2 on allotment and Rs.6 on I and final call. The company received applications for 2,00,000 shares and pro-rata allotment was made. Pass necessary journal entries and prepare cash book, assuming all the installments were duly received.

Bank A/**C Dr.** 4,00,000

To Sh. Application A/C 4,00,000

(Being application money rec. for 2lac sh)

Sh. Application A/C Dr. 2,80,000

To Sh.Capital A/C 2,80,000

(Being application money tr to Sh Capital)

Sh. Application A/C Dr. 1,20,000

To Sh. Allotment A/C 1,20,000

(Being excess app money tr to allotment)

Sh. Allotment A/C Dr. 1,60,000

To Sh. Capital A/C 1,60,000

(Being allotment money due)

Bank A/C Dr. 1,60,000

To Sh. Allotment A/C 1,60,000

(Being allotment money received)

Sh. I call A/C Dr. 8,40,000

To Sh.Capital 8,40,000

(Being sh I call money due)

Bank A/C Dr. 8,40,000

To Sh. I & Final Call A/C 8,40,000

(Being Sh I & Final Call money received)

CASH/ BANK ACCOUNT

To Sh. Application	4,00,000	By Balance c/d	14,00,000
To Sh. Allotment	1,60,000		
To Sh I & Final Call	8,40,000		
	14,00,000		14,00,000

ISSUE AT PREMIUM:

3. Dee Ltd. Offered to the public 20,000 equity shares of Rs.100 each at a premium of Rs.10 per share. The payment was to be made as follows:

On application Rs.20; On allotment Rs.40 (including premium); On 1st Call Rs. 25 and on II call Rs.25. Applications totalled for 35,000 shares; applications for 10,000 shares rejected; those totalling 15,000 shares were allotted 10,000 shares and the remaining applications were accepted in full. The directors made both the calls.

One shareholder holding 500 shares (full allotee) failed to pay the calls. Expenses of the issue amounted to 10,000. Pass Journal entries and relevant extracts from the balance sheet relating to the above transactions.

Bank A/C Dr.	7,00,000	
To Sh. Application		7,00,000
(Being applicaltion money received for 35,000)		
Sh. Application A/C Dr	4,00,000	
To sh. Capital		4,00,000
(Being application money tr to capital)		
Sh. Application A/C Dr	2,00,000	
To Bank		2,00,000
(Being application rejected for 10000 shares and amount refunded)		
Sh. Applicaltion A/C Dr.	1,00,000	
To Sh. Allotment		1,00,000
(Being excess application money on 5000 shares tr to allotment)		

OR

Combined entry:

Sh. Application A/C Dr.	7,00,000	
To Bank A/C		4,00,000
To Sh. Capital A/c		2,00,000
To Sh. Allotment A/c		1,00,000
(Being Sh. Application money adjusted)		

Bank A/C Dr	7,00,000	
To Sh. Allotment A/c		7,00,000
(Being allotment money rec)		
Sh. I Call A/C Dr	5,00,000	
To Sh. Capital		5,00,000
(Being I call money due)		
Bank A/C Dr	4,87,500	
To Sh I Call		4,87,500
(Being sh I call money received expect on 500 shares)		
Sh II & Final Call A/C Dr	5,00,000	
To Sh. Capital		5,00,000
Sh. Allotment A/C Dr	8,00,000	
To Sh. Capital		6,00,000
To Sh. Premium A/C		2,00,000
(Being allotment money due along with premium		
(Sh II & final call money due)		
Bank A/c Dr.	4,87,500	
To Sh II & Final Call		4,87,500
(Being Sh II & final call money received except on 500 shares)		

Expenses A/C Dr. 10,000

To Bank A/C 10,000

(Being expenses amounted to Rs.10,000)

ISSUE AT DISCOUNT:

4. In December 1989, Delhi Cement Co. Ltd. Issued 1,000 shares of Rs.100 each at a discount of 5%. The issue was fully subscribed by paying Rs.20 per share on application. The balance was payable as to Rs.20 per share on allotment after discount: Rs.25 on I call and Rs.30 on final call.

All calls were made and recovered with an exception of final call on 100 shares held by one Mr. Ram.

Pass JE and show BS.

Bank A/C Dr. 20,000

To Sh. Application A/C 20,000

(Being application money received)

Sh. Application A/C Dr. 20,000

To Sh. Capital 20,000

(Being sh. App tr to sh. capital)

Sh. Allotment A/C Dr 20,000

Sh.Discount A/C Dr 5,000

To Sh. Capital A/C 25,000

(Being allotment money due)

Bank A/C Dr 20,000

To Sh. Allotment A/C 20,000

(Being allotment money received)

Sh I call A/C Dr 25,000

To Sh.Capital A/c 25,000

(Being Sh I call money due)

Bank A/C Dr	25,000	
To Sh I call A/c		25,000
(Being Sh I call money received)		
Sh II & Final Call A/C Dr.	30,000	
To Sh. Capital		30,000
(Being Sh II & Final call money due)		
Bank A/C Dr	27,000	
To Sh II & Final call A/c		27,000

BANK A/C

To Sh. Application	20,000	By balance c/d	92,000
To Sh. Allotment	20,000		
To Sh I call	25,000		
To Sh Final Call	27,000		
	92,000		92,000

BALANCE SHEET

LIABILITIES			ASSETS	
Authorised Capital		XXX	CAB	92,000
Issued, Subscribed,			Discount on issue	5,000
Called up and paid				
(1000X100)	1,00,00			
Less: Calls in arrears		3,000		
		97,000		97,000

CALLS IN ARREARS AND CALLS IN ADVANCE:

5. AB Ltd issued 10,000 equity shares of Rs.10 each at a discount of 10% payable as follows:
Rs. 2 per share on application; Rs. 2 per share on allotment and Rs. 2 per share on I call and Rs.3 per share on final call.

Applications were received for 12,000 shares and the directors allotted 10,000 shares and refunded the application money for 2,000 shares.

The allotment money was duly received on all the shares. One shareholder holding 1,000 shares did not pay the first and final calls. Another shareholder holding 200 shares paid the final call money along with the first call itself. Pass JE.

Bank A/C Dr.	24,000	
To Sh. Application A/c		24,000
(Being application money received for 12,000 shares)		
Sh. Application A/C Dr .	24,000	
To Bank A/c		4,000
To Sh Capital A/C		20,000
(Being application money tr to capital and Application for 2000 sh rejected and amt refunded)		
Sh. Allotment A/C Dr	20,000	
Sh. Discount A/C Dr	10,000	
To Sh. Capital A/c		30,000
(Being allotment money due)		
Bank A/C Dr	20,000	
To Sh. Allotment A/C	20,000	
(Being allotment money received)		
Sh I Call A/C Dr	20,000	
To Sh. Capital A/c		20,000
(Being Sh I call money due)		
Bank A/C Dr	18,600	
To Sh I call A/C		18,000
To Calls – in - advance		600
(Being Sh I call money received & advance money Received on 200 shares for final call)		

Sh. II & Final Call A/C Dr.	29,400	
To Sh. Capital A/c		29,400
(Being Sh II & Final call money due)		

Bank A/C Dr	26,400	
To sh II & Final Call A/c		26,400
(Being final call money received except on 1000 shares)		

FORFEITURE & RE-ISSUE:

6. X Ltd forfeited 30 shares of Rs. 10 each fully called up, held by Murugan for non-payment of allotment money of Rs.3 per share and first and final call of Rs.4 per share. He had paid the application money of Rs.3 per share. These shares were reissued to David for Rs.8 per share. Pass JE for forfeiture & re-issue.

Sh. Capital A/c Dr.	300	
To Sh. Allotment A/C		90
To Sh I and Final Call		120
To Sh Forfeiture A/c		9 0
(Being 30 shares forfeited for the non-payment of allotment, I and final call money)		

Bank A/C Dr.	240	
Forfeited shares A/c Dr.	60	
To sh. Capital A/c		300
(Being forfeited shares re-issued at Rs. 8 per share to David)		

Forfeited shares A/c Dr.	30	
To Capital Reserve A/C		30
(Being amount transferred to capital reserve)		

7. The directors of R ltd resolved on 1st may 2000 that 2000 shares of Rs.10 each, Rs.7.50paid, be forfeited for non- payment of Final call money of Rs.2.50. On June 10, 2000 out of the above 1,800 shares were reissued for Rs.6 per share. Show JE.

Solution:

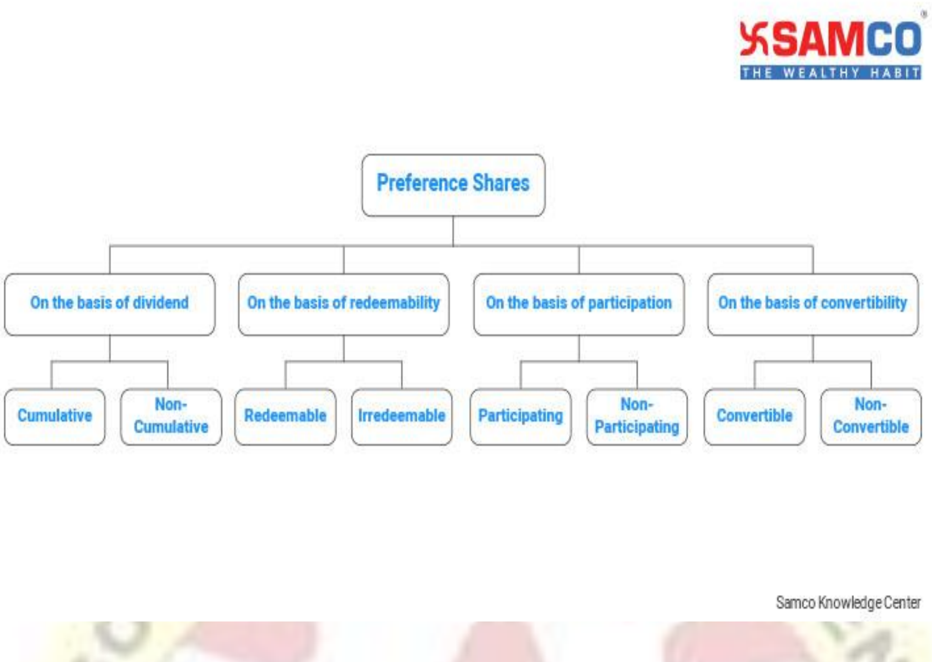
Sh. Capital A/c Dr.	20,000	
To Sh. Final call A/c		5000
To sh. Forfeiture a/c	15,000	
(Being 2000 shares forfeited)		
Bank A/C Dr.	10,800	
Sh. Forfeiture a/c Dr.	7,200	
To Sh. Capital a/c	18,000	
(Being 1800 shares reissued at 6 per share)		
Sh. Forfeiture a/c Dr.	6300	
To Capital Reserve		6300
(Being amt tr to capital reserve)		

REDEMPTION OF PREFERENCE SHARES

1. What is Preference shares?

Preference shares are a special type of shares. They promise the preference shareholder to have preference in sharing profits over equity shareholders. Preference shareholders are paid dividends before equity shareholders.

2. Explain the various types of preference shares.



In previous sections we have discussed different sources of capital. Equity shares get dividend at a rate fixed at the Annual General Meeting (AGM) depending on the profit available for a particular year. The rate of dividend also varies from year to year. The preference shareholders contribute capital to the company. According to section 85 of the Companies Act, 1956, persons holding preference shares, called preference shareholders. They are assured of a preferential dividend at a fixed rate during the life of the company. This type share holders carry preferential right over other shareholders to be paid first in case of liquidation of the company. Companies use this mode of financing as it is cheaper than raising debt. The preference shares can be of various types. These are:

i) **Redeemable Preference Shares:** A company may issue this type of shares on the condition that the company will repay the amount of share capital to the holders of this category of shares after the fixed period or even earlier at the discretion of the company. Section 80 of the Companies Act, 1956 deals with the redemption of preference shares.

ii) **Irredeemable Preference Shares:** The preference shares, which do not carry the agreement of redemption are known as irredeemable preference shares.

iii) **Convertible Preference Shares:** This type of shares enjoy the right to the holder to get them converted into equity shares according to the terms and conditions of the issue.

iv) **Non-convertible Preference Shares:** The holders of these shares do not enjoy the right to get the shares converted into equity shares. Unless otherwise stated, Preference shares are non-convertible.

v) **Participating Preference Shares:** The holder of this type of preference shares enjoy the right to participate in the surplus profits, if any, after the equity shareholders have been paid dividend at a rate fixed in the AGM. So the shareholders get additional dividend with their normal dividend.

vi) **Non-participating Preference Shares:** These shares carry only a fixed rate of dividend without any right to get additional dividend. Unless otherwise stated, The preference shares are non-participating.

vii) **Cumulative Preference Shares:** The cumulative preference shares carry the right to a fixed amount of dividend. The holders of these shares are entitled to get dividend out of future profit if current year's profit is insufficient for the same. So, the dividend on these shares accumulates till the final payment.

viii) **Non-cumulative Preference Share:** In this case the dividend for the shareholders does not accumulate. If there is no sufficient profit, this type of preference shareholders will not get any dividend. In this case, the dividend will be lapsed and there will be no arrear dividend.

3. What are the conditions for redemption of preference shares?

Before going to redeem the preference shares as per section 80 of the Companies Act, 1956, a company should have to follow the conditions: i) There must be a provision in the Articles of Association regarding the redemption of preference shares. ii) The redeemable preference shares must be fully paid up. If there is any partly paid share, it should be converted in to fully paid shares before redemption. iii) The redeemable preference shareholders should be paid out of undistributed profit/ distributable profit or out of fresh issue of shares for the purpose of redemption. iv) If the shares are redeemed at a premium, it should be should be provided out of securities premium or profit and loss account or general reserve account. v) The proceeds from fresh issue of debentures cannot be utilized for redemption. vi) The amount of capital reserve cannot be used for redemption of preference shares. vii) If the shares are redeemed out of undistributed profit , the nominal value of share capital, so redeemed should be transferred to Capital Redemption Reserve Account. This is also known as capitalization profit.

4. What is meant by Capital Redemption Reserve?

It will be clear that, if the preference shares are redeemed out of accumulated profit, it will be necessary to transfer an amount equal to the amount repaid on the redemption to Capital Redemption Reserve Account. If the company issues any fresh shares for redemption purpose, the transferred amount will be the difference between nominal value of shares redeemed and the nominal value of shares issued (i.e.

amount transferred to CRR = Nominal value of shares redeemed – Nominal value of shares issued). The capital redemption reserve account can be used for issuing fully paid bonus shares.

The importance of creation of capital redemption reserve account are to a) protect the interest of creditors and b) maintain working capital. Redemption of preference shares involves repayment of capital before paying creditors of the company. It may affect the interest of creditors. In addition to that the working capital of the company will be depleted as a result of outflow of cash due to redemption. The amount is capitalized by creating the capital redemption reserve account. As a result this amount will not be available for distribution of dividend. It help protect the interest of creditors and on the other hand it replenishes working capital.

Problems on Redemption of Preference Shares:

Redemption Of Preference Shares At Premium

1. A Limited Company issued on 1st July 2000, 10,000 redeemable preference shares of Rs. 10 each. Such shares were redeemable at a premium of 10%. Two-fifths of this issue was redeemed out of profits on 10th January 2004. On 20th January 2004, the Company issued 20,000 equity shares of Rs.10 each at a premium of Rs.4 per share. Out of the proceeds of such issue, the balance of Redeemable Preference Shares was redeemed.

   Make journal entries to record these transactions in the books of the company.

Solution

Journal Entries

Date	Particulars		Debit	Credit
July 1, 2000	Bank A/C	Dr	1,00,000	
	To Redeemable Pref sh Capital A/c			1,00,000
	(Being issue of 10,000 shares of Rs. 10 each)			
Jan 1, 2004	Profit & Loss Appropriation A/c	Dr	44,000	
	To Capital Redemption A/c			40,000
	To Premium on Redemption A/c			4,000
	(Being provision for the redemption of 4,000			
	Redeemable preference shares of Rs.10			

	each at a premium of 10%)		
Jan 10, 2004	Redeemable preference shares Capital A/c Dr	40,000	
	Premium on Redemption A/c ` Dr	4,000	
	To Redeemable preference share holders A/c		44,000
	(Being amount due to shareholders on Redemption)		
Jan 10, 2004	Redeemable Preference shareholders A/c	44,000	
	To Bank Account		44,000
	(Being payment made to shareholders)		
Jan 20, 2004	Bank A/c	2,80,000	
	To Eq. sh. Capital A/c		2,00,000
	To Sh.Premium A/c		80,000
	(Being issue of 20,000 Eq.Sh)		
Jan 20, 2004	Premium on Issue of Shares a/C	6,000	
	To Premium on Redemption A/c		6,000
	(Being provision for premium on Redemption)		
Jan 20, 2004	Redeemable Pref.Sh. Capital A/c	60,000	
	Premium on Redemption A/c	6,000	
	To Redeemable Pref.Sh.Holders A/c		66,000
	(Being the amount due to shareholders on redemption)		
Jan 20, 2004	Redeemable Pref.Sh.Holders A/c Dr	66,000	
	To Bank A/c		66,000
	(Being amount paid to Pref.Sh.Holders a/c)		

Redemption Of Shares At Premium, Partly Out Of Profits And Partly Out Of Fresh Issue

2. X and Company issued 50,000 Equity Shares of Rs. 10 each and 3,000 Redemption Preference Shares of Rs.100 each. all shares being fully called and paid up. On 31st March 2004, Profit and Loss Account showed an undistributed profit of Rs.50,000 and the General Reserve Account stood

at Rs.1,20,000. On 2nd April 2004, the directors decided to issue 1,500 6% Preference Shares of Rs.100 each for cash and to redeem the existing Preference Shares at Rs.105 utilizing as much profits as would be required for the purpose.

Show the journal entries to record these transactions.

Solution:

Date	Particulars		Dr (Rs.)	Cr (Rs.)
April 2, 2004	Bank A/C	Dr	1,50,000	
	To 6% Pref.Sh.capital a/c			1,50,000
	(Being issued 1500 prefsh @ Rs.100 each)			
April 2, 2004	General Reserve A/c	Dr	15,000	
	To Premium on Redemption A/c			15,000
	(Being Premium on redemption is met out of General reserve)			
April 2, 2004	General Reserve A/c	Dr	1,05,000	
	P/L Appropriation A/c	Dr	45,000	
	To Capital Redemption Reserve			1,50,000
	(Being amount transferred to capital redemption reserve)			
April 2, 2004	Redeemable Preference sh.capital A/c	Dr	3,00,000	
	Premium on Redemption A/c	Dr.	15,000	
	To Preference sh.holders A/c			3,15,000
	(Being amount due)			
April 2, 2004	Pref. Sh.holders a/c	Dr	3,15,000	
	To Bank			3,15,000
	(Being amount paid to Pref. sh. holders)			

3. Where Minimum Number Of Equity Shares Is To Be Issued For Redemptions

The summarized Balance Sheet of a Company is given below:

Liabilities	Rs.	Assets	Rs.

Eq.sh.Capital fully paid @10 each	1,00,000	Fixed assets	1,50,000
7% Red. Pref.Shares@80 per share called up and paid up	80,000	Current assets	58,000
Share premium	3,000		
Creditors	10,001		
P/L A/c	14,991		
Total	**2,08,000**	**Total**	**2,08,000**

Solution:

Particulars	Debit Rs	Credit Rs.
7% Redeemable Pref. Share Final call A/C Dr. To Red. Pref. Sh.Capital A/c (Being final call of Rs. 20 per share made)	20,000	 20,000
Bank A/C Dr. To Red. Pref.Share Final call (Being Final call received on final call)	20,000	 20,000
Bank A/c Dr To Eq. Sh.Capital To Share Premium A/c (Being fresh issue of equity share at a premium of 5%)	92,001	 97,620 4,381
Share Premium A/c Dr Profit & Loss A/C DR TO PREMIUM ON REDEMPTION A/C (BEING PREMIUM PAYABLE ON REDEMPTION)	7,381 2,619	 10,000
Profit and Loss A/c Dr To Capital Redemption Reserve (Being provision created for redemption of preference shares)	12,380	 12,380

7% Redeemable Preference share capital Dr Premium on redemption To Redeemable Pref.Sh. Holders A/c (Being amount due to preference sh.holders)	1,00,000 10,000	 1,10,000
Redeemable Preference share Holders A/c Dr To Bank A/c (Being amount paid to preference share holders A/c)	1,10,000	 1,10,000

UNIT II DEBENTURES

1. What is meant by redemption of Debentures?

Redemption of debentures refers to payment of the amount of debentures by the enterprise. When debentures are reclaimed, liability on account of debentures is being discharged. To put it in other words, the amount of capital needed for redemption of debentures is large and, hence, economic enterprises make adequate provision out of gains and accrue capital to reclaim debentures.

2. Explain the way of redemption of debentures?

- **Payment in lump sum :** The enterprise reclaims the debentures by paying the fund in lump sum (round sum) to the debenture holders during the maturity hereof as per the terms and conditions of issue.
- **Payment in instalments:** Under this method, usually redemption of debentures is paid in instalments on the particular date during the time in the position of the debentures. The total amount of debenture liability is being divided by the total number of years. This must be noted that the authentic debentures reclaimable are recognised by the sources of drawing the required number of lots out of the debentures outstanding for the payment.
- **Purchase in open market:** When an enterprise buys its own debentures for the aim of cancellation, such an act of buying and cancelling the debentures comprises redemption of debentures by purchase in the open marketplace.
- **Conversion into shares or new debentures:** An enterprise can reclaim its debentures by transforming them into a new class of debentures or shares. If debenture holders find that the proffer is useful to them, they can exercise their right of transforming their debentures into new class of debentures or shares. These new shares or debentures can be either circulated at a

premium, at a discount or at par. It may be noted that this method is applicable only to convertible debentures.

3. **Define the meaning of Debentures and its various types.**

Debentures: A debenture is written acknowledgement of debt by a company under its common seal, generally secured by floating change on company"s assets. Interest is paid to debenture holders at a fixed rate at regular intervals.

Types of Debentures:

(a) **Registered Debentures:** Debentures which are transferable only by transfer deed.

(b) **Bearer Debentures:** Debentures which are transferred by mere delivery and the company does not keep the record of debenture holders.

(c) **Redeemable Debentures:** Debentures which are redeemed after specified period of time.

(d) **Irredeemable Debentures:** Such debentures are payable after a long period of time (not pre decided) or on winding up of the company.

(e) **Convertible Debentures:** Debentures which are convertible into shares or new debentures.

(f) **Non-Convertible Debentures:** Debentures which can not be converted into shares or new debentures.

(g) **Secured or Mortgage Debentures:** Debentures which are secured on particular assets or on general assets of the company.

(h) **Unsecured or Naked Debentures:** The debentures which are not secured on any asset.

(i) **Zero Interest Debentures:** Debentures on which no interest is paid by the company. Such debentures are either issued at heavy discount or such debentures are converted into equity shares offered at low rate.

Problems:

1. A company issued 1,000 10% debentures of Rs.100 each at par, Rs. 40 on application, and the balance on allotment. The public applied for 800 debentures. These applications were accepted. All money were received.

Particulars	Debit (Rs)	Credit (Rs)
Bank A/c Dr	32,000	

To Debenture application A/c (Being application money received on 800 debenture)		32,000
Debenture application A/c Dr To 10% Debenture capital a/c (Being transfer of application money)	32,000	32,000
Debenture allotment a/c Dr To 10% debenture a/c Bank To Debenture allotment A/c (Being allotment money received on debentures)	48,000	48,000 48,000

2. You are required to pass Journal entries for the issue of following debentures

(a)120 10% Debentures of Rs.1,000 are issued at a discount of 5% and repayable at par.

(b) Another 150,7% Rs.1,000 debentures are issued at 5% discount and repayable at 10% premium.

(c) Further 80, 9% Rs.1,000 debentures are issued at 5% premium.

(d) In addition another 400 8% Rs. 100 debentures are issued as collateral security against a loan of Rs.4,000

Particulars	Debit	Credit
(A)Bank a/c Dr Discount on issue of Debetures A/c Dr To 10% Debenture A/c (Being 120 debentures issued at a discount of 5%)	1,14,000 6,000	1,20,000
(B)Bank a/c Dr Loss on issue of debentures a/c Dr To 7% Debentures A/c To Premium on redemption of	1,42,500 22,500	1,50,000 15,000

debentures a/c (Being debentures received on the issue of 150 debentures and repayable on premium of 10%)		
(C) Bank A/c Dr To 9% Debentures A/c To Premium on issue of debentures A/c (Being issue of 80 debentures)	84,000	 80,000 4,000
(D)Debenture suspense a/c To 8% Debenture a/c (Being issue of 400 8% debenture as collateral against a loan)	40,000	 40,000

3. B.K. Ltd. issued at Rs 1, 00,000 10% Debenture at 95%. Subscriptions are payable as to Rs 20,000 on application and balance on allotment. Expenses of the issue are Rs 500.

   Show the journal entries and the Balance Sheet of the Company.

   Solution:

Particulars	Debit (Rs.)	|Credit (Rs.)
Bank A/c Dr. To 10% Debenture application a/c (Being issue of debentures and receipt of application money)	20,000	 20,000
10% Debenture application A/c To Debenture a/c (Being application money transferred to debenture a/c on allotment)	20,000	 20,000
10% Debenture allotment account Dr Discount on issue of debenture A/c Dr	75,000 5,000	

To 10% Debenture a/c (Being allotment money due)		80,000
Bank A/c Dr To 10% Debenture allotment A/c (Being allotment money received)	75,000	 75,000
Expenses a/c Dr To Bank A/c (Being expenses on issue of debenture)	500	 500

Balance Sheet of B.K Ltd

Liabilities	Rs.	Assets	Rs	Rs.
Secured loan				
10% Debentures a/c	1,00,000	Current assets:		
		Bank		94,500
		Misc. Expenses:		
		Expenses on issue	500	
		Discount on Debentures	5,000	5,500
	1,00,000		1,00,000	

4. In the Balance Sheet of a Company, the discount on debentures shows a debit balance of Rs 15,000. Every year Rs 5,000 is charged off to Profit and Loss Account. How will you show the Discount on Debentures Account at the end of the First Year and Second Year in the Balance Sheet of the Company?

Solution:

Balance Sheet (First year)

Assets Side:

Miscellaneous Expenditure:

Discount on debenturese	15,000	
Less: Charged to P/L A/c	5,000	10,000

Balance Sheet (Second year)

Assets Side:

Miscellaneous Expenditure:

Discount on debentures	10,000	
Less: Charged to P/L A/c	5,000	5,000

PROFIT PRIOR TO INCORPORATION:

1. Mukesh and co Ltd was registered on 1-1-99 to buy the business of M/s. Mukesh Bros., as on 1-10-98 and obtained the certificate of commencement of business on 1-2-99. The accounts of the company for the period of 12 months ended 30-9-99 disclosed the NP of Rs.1,25,000 after having charged the following:

Salary: Rs. 30,000 (There were 4 employees in the pre incorporation period and 7 in the post incorporation period.)

Wages: Rs. 10,920 (There were 4 workers in the pre-incorporation period and 5 in the post-incorporation period and the rate of wages were Rs.160 and Rs.200 per month per worker in the pre and post incorporation periods respectively)

Sales: Rs. 4,80,000 of which Rs.80,000 related to the pre incorporation period.

Director Fees: Rs. 16,000.

You are required to calculate Profit the pre and post incorporation periods.

Solution:

Particulars	Basis of Apportionment	Total	Pre-incorporation	Post-incorporation
Gross Profit before charging wages Less: Wages	SR (1:5) Actual	181920 10920 1,71,000	30320 1920 28,400	151600 9000 1,42,600
Salaries	Weighted Time Ratio	30,000	4,800	25,200

Directors Fees	Post	16,000	------	16,000
Total Expenses		46,000	4,800	41,200
Net Profit (A - B)		1,25,000	23,600	1,01,400

Working Notes:

(1) Gross profit before charging wages:

Net Profit given		1,25,000
Add: Salaries		30,000
Directors fees	16,000	
Gross Profit		1,71,000
Add: Wages		10,920
Gross profit before charging wages		1, 81,920

(2) Calculation of Sales Ratio:

Pre – Incorporation sales = 80,000

Post-Incorporation sales = 4,00,000

Sales Ratio - 80,000: 4,00,000 (or) 1:5

(3) Weighted Time Ratio:

Pre – Incorporation period from 1/10/98 to 31/12/98 – 3 months

Employee in Pre-incorporation period - 4

Post-Incorporation period from 1/1/99 to 30/9/99 – 9 months

Employee in Post-incorporation period – 7

Weighted Time Ratio = 1 X4 : 3X7 = 4:21

(4) Actual Wages:

No. of months	3	9
No.of workers	4	5
Wages per month	160	200
Actual Wages	3x4x160	9x5x200
	Rs.1920	Rs.9000

2. Jones Ltd was incorporated on 1st April 1996 ti purchase the business of Kumaresan with effect from 1st January 1996. The following details are available from the compnay's books of accounts on 31.12.96

Particulars	Rs.	Particulars	Rs.
Salaries	44,000	Preliminary expenses	15,000
Insurance	6000	|Carriage outwards	6000
Depreciation	12000	Rent	4000
Stationery	8000	Directors fees	3000
Advertising	9600	Donation to charitable causes	8000
Interest paid to vendors	7500	Discount allowed	8000
Provision for bad and doubtful debts created on 31.12.96	3000		

1. Sales for the year were Rs.4,00,000 of which 80,000 were in the pre incorporation period.
2. Insurance was for the 12 months ending 31st March 1997.
3. 2/3 of the preliminary expenses are to be written off.
4. Salaries were paid for 11 months. One month salary is outstanding.
5. Gross profit for the year was Rs.1,80,000

   Prepare profit and loss account, clearly showing the profit or loss in the pre incorporation period.

Solution:

Pre-Incorporation Period from 1/1/96 to 31/3/96 = 3 months

Post-Incorporation period from 1/4/96 to 31/12/96 = 9months

Time Ratio = 3:9 or 1:3

Sales Ratio = 80,000: 3,20,000 or 8:32 or 1:4

Workings:

Salaries = 44,000 for 11 months

Therefore for 12 months 11 -44,000

12 - ?   12 x 44,000/11 =48,000

Statement Showing Pre & Post Incorporation profit of Jones Ltd for the year ended 31.12.97

Particulars	Basis of apportionment	Total	Pre-Incorporation period	Post-Incorporation Period
Gross Profit (A)	Sales Ratio (1:4)	1,80,000	36,000	1,44,000
Expenses: Salaries	Time Ratio (1:3)	48,000	12,000	36,000
Insurance	Post	4500	-----	4,500
Depreciation	Time Ratio (1:3)	12,000	3,000	9,000
Stationery	Time Ratio (1:3)	8,000	2,000	6,000
Advertisment	Sales Ratio (1:4)	9600	1920	7680
Interest paid to vendors	Time Ratio (1:3)	7500	1875	5625
Provision for Bad and Doubtful debts	Sales Ratio (1:4)	3000	600	2400
Pre.Expenses	Post	10000	------	10,000
Carriage outwards	Sales Ratio (1:4)	6000	1200	4800
Rent	Time Ratio (1:3)	4000	1000	3000
Directors Fees	Post	3000	---	3000
Donation	Time Ratio (1:3)	8000	2000	6000
Discount allowed	Sales Ratio (1:4)	2000	400	1600
Total Expenses (B)		125600	25995	
Net ProfitC =A-B		**54400**	**10005**	**44395**

UNDERWRITING

1 . What do you mean by underwriting?

Underwriting’ refers to the functions of an under-writer. An under-writer may be an individual, firm or a joint stock company, performing the under-writing function. Under-writing may be defined as a contract entered into by the company with persons or institutions, called under-writers, who undertake to take up the whole or a portion of such of the offered shares or debentures as may not be subscribed for by the public. Such agreements are called ‘Under-writing agreement’.

2. What is the underwriting commission payable?

It may be paid in cash or in fully paid-up shares or debentures or a combination of all theseCompanies Act, 2013 provides that payment of commission should be authorized by Articles of Association and the maximum commission payable will be as under:In case of shares 5% of the issue price of the shares In case of debentures 2 % of the issue price of the debentures

3. What is meant by Firm underwriting?

Under this type of agreement, the underwriter agrees to take up a specified number of shares irrespective of the number of shares subscribed for by the public. Unless it has otherwise agreed, the underwriters' liability is determined without considering the number of shares taken up 'firm' by him. For Example, the entire issue X Ltd. Is underwritten as follows: A 1,60,000 Shares (Firm Underwriting 3,600 Shares) B 1,60,000 Shares (Firm Underwriting 2,000 Shares) C 80,000 Shares (Firm Underwriting 1,200 Shares) D 80,000 Shares (Firm Underwriting 10,000 Shares) In this case only 4,63,200 shares (i.e. 4,80,000 shares – firm underwriting of 16,800 shares) will be offered to public and 16,800 shares will be taken by the underwriters even if the issue is over subscribed.

4. What is full and partial underwriting?

Full underwriting:

When the whole issue is underwritten by the underwriter(s) it is called as full underwriting.

For Example, X Ltd. Decided to make a public issue of 1,00,000 equity shares of Rs.10 each which is entirely underwriter by A, B, C, D in the ratio of 2:2:1:1 In such case, the benefit of unmarked applications is given to the underwriter in the ratio of their gross liability.

Partial underwriting:□ When a part (say 75%) of the whole issue is underwritten by the underwriters it is called as partial underwriting.

For Example, X Ltd. Decided to make a public issue of 1,00,000 equity shares of Rs.10 each out of which 90,000 shares are underwritten by A, B, C, D in the ratio of 2:2:1:1. It means 10,000 shares are underwritten by Company itself. In this case if figure of marked application is not given separately, (Marked applications = Total number of applications received x percentage of underwriting.) For the uncovered portion we can say company is liable, but company will not take its own share rather it will remain unsubscribed.

5. How to calculate Liability of underwriter?

S. No.	Particulars	Basis	A	B
A	Gross Liability	Ratio of shares underwritten	Xxx	Xxx
B	Less: Marked applications	Actual	Xxx	Xxx
C	Balance (A - B)		Xxx	Xxx
D	Less: Unmarked applications allotted in the ratio of gross liablitliy	Ratio of Gross liability	Xxx	Xxx
E	Balance (C - D)		Xxx	Xxx
F	Less: Firm underwriting	Actual or Ratio of gross liability	Xxx	Xxx
G	Net liablility		Xxx	Xxx
H	Add: Firm underwriting		Xxx	Xxx
I	Total liability		Xxx	Xxx

Question No. 1 (Partial Underwriting)

A Company issued 100,000 shares of $100 each. These shares were underwritten as follows:

X—-30,000 shares and Y—— 50,000 shares.

The public applied for 70,000 shares. Determine the liability of X, Y and the Company.

Answer

Marked applications are not given in the problem. Therefore, applications be credited to underwriters including the Company on the basis of gross liability. The Company itself to be treated as an underwriter for 20,000 shares.

Statement showing Individual Underwriters' Liability

	X	Y	Company	Total
Gross Liability	30,000	50,000	20,000	100,000
Less: Application received in the ratio of 30:50:20	21,000	35,000	14,000	70,000
Next L:iability	9,000	15,000	6,000	30,000

Alternatively:

Unsubscribed shares = 100,000 - 70,000 = 30,000

Thus the net liability of	X	= 30,000 x 30/100	= 9,000 shares
	Y	= 30,000 x 50/100	= 15,000 shares
	Company	= 30,000 x 20/100	= 6,000 shares

Question No. 2 (Full underwriting)

A Company incorporated on 1st January, 2019 issued a prospectus inviting applications for 500,000 Equity Shares of $10 each.

The whole issued was fully underwritten by four persons:

A ———- 200,000 shares

B ——— 150,000 shares

C ——— 100,000 shares

D ——— 50,000 shares

Applications were received for 450,000 shares of which marked applications were as follows:

A —— 220,000;

B —— 90,000;

C —— 110,000;

D —— 10,000

Find out the liabilities of individual underwriters.

Answer

	A	B	C	D	Total
Number of shares underwritten	200,000	150,000	100,000	50,000	500,000
Less: Credit for unmarked forms (20 : 15: 10 : 5)	8,000	6,000	4,000	2,000	20,000
Liability after the credit of unmarked forms	192,000	144,000	96,000	48,000	480,000
Less: Relief for marked forms	220,000	90,000	110,000	10,000	430,000
Resultant Liability	-28,000	54,000	-14,000	38,000	50,000
Division of Surplus of A and C to B and D in 15 : 5 ratio	+28000	-31,000	+14,000	-10,500	-
(i.e., 28,000 + 14,000 = 42,000)					
Net Liability	**Nil**	**22,500**	**Nil**	**27,500**	**50,000**

Number of unmarked applications = Total Shares applied for - Marked applications

= 4,50,000 - 4,30,000 = 20,000 shares

Note: When the entire issue is underwritten by a single underwriter, there is no necessity to distinguish between marked and unmarked applications and the liability for the underwriter would be 50,000 shares.

Question No. 3 (Firm Underwriting)

John Limited issued 10,000 shares of $100 each. The entire issue was underwritten as follows:

A—-50%; B——30%; C——20%;

In addition, there was firm underwriting as follows:

A—-1,000 shares;

B—-750 shares;

C—-500 shares

The total subscription including firm underwriting was 8,000 shares and the subscription included the following marked applications:

A——1,500

B——2,000

C——750

Find the liability of underwriters.

Answer

	A	B	C	Total
Gross Liability	5,000	3,000	2,000	10,000
Less: Credit for unmarked forms (8,000 - 4,250) in 5 : 3 : 2	1,875	1,125	750	3,750
	3,125	1,875	1,250	6,250
Less: Relief for Marked forms	1,500	2,000	750	4,250
	1,625	-125	500	2,000
Less: Division of surplus of B to A and C in 5 : 2	-89	+125	-36	
	1,536	-	464	2,000
Add: Firm underwriting	1,000	750	500	2,250
Net Liability	2,536	750	964	4,250

Question No. 4

The following underwriting takes place:

A—-5,000 shares

B—-3,000 shares

C—-2,000 shares

In addition there is firm underwriting:

A—-1,000 shares

B—-500 shares

C—-1,500 shares

The shares issue is 10,000 shares. Tortal subscription including firm underwriting was 8,500 shares and the forms included the following marked forms:

A—2,000 shares; B—-1,000 shares and C—-1,000 shares.

Show the allocation of liability of the underwriters.

Answer:

	A	B	C	Total
Shares underwritten	5,000	3,000	2,000	10,000
Less: Allowance of unmarked foms in 5 : 3 : 2	2,250	1,350	900	4,500
	2,750	1,650	1,100	5,500
Less: Marked forms	2,000	1,000	1,000	4,000
	750	650	100	1,500
Add: Firm underwriting	1,000	500	1,500	3,000
	1,750	1,150	1,600	4,500

Question No. 4

A Company issued a prospectus inviting applications for 20,000 Equity Shares of $100 each. The whole issue was fully underwritten by three underwriters as follows:

A—-10,000shares

B—-7,000share

C—-3,000 share

Applications were received for 16,000 shares of which marked applications were as follows:

A—-7,600shares

B—-4,040shares

C—-3,360 shares

Show how the liability of the underwriting it to be completed.

Answer:

	A	B	C	Total
Shares underwritten	10,000	7,000	3,000	20,000
Less: Credit for direct applications (16,000 - 15,000) in 10 : 7 : 3	500	350	150	1,000
	9,500	6,650	2,850	19,000
Less: Relief for personal performance	7,600	4,040	3,360	15,000
	1,900	2,610	-510	4,000
Less: Surplus of C distributed to A and B in 10 : 7	-300	-210	+510	-
Final Liability	1,600	2,400	-	4,000

UNIT III FINAL ACCOUNTS

1.What do you understand by Final Accounts of a Company?

Ans.: To show the profit earned during the year and financial position of company at a particular date. It is compulsory for a company to prepare Profit and loss account and Balance Sheet – called at the end of the year as per section 209 of the Indian Companies Act, 1956. Such accounts are called final account of a company.

2 What is Managerial Remuneration?

Ans.: The remuneration given to managerial persons including director, managing director, manager for their services is called managerial remuneration.

Q.3 Discuss the Provisions of Companies Act, 1956 regarding Managerial Remuneration.

Ans.: The remuneration to directors is governed by the section 198 and 309 of the companies Act. The amount of remuneration is to be determined by the articles or by a resolution passed by the company in the general meeting of shareholder or by a special resolution if the articles so required.

A whole time or managing director or manager may be paid remuneration by way of monthly pay and /or by way of specified percentage of net profits of the company.

companies having profit rate%

(1)	Overall (excluding fees for attending meeting)	11% of Net profit in all
(2)	If there is one whole time/ Managing director/ manager	5% of Net profit
(3)	If there are two or more whole time directors including managing director	10% of Net profit in all
(4)	Remuneration to part time directors: (a) If there is no managing or whole time director in the company (b) If there is a managing or whole time director.	3% of net profit in all 1% of net profit in all

Problems:

1.The provisions for tax at the end of 31.3.01 stood at Rs.3,00,000. During 2001-02 the tax liabilities upto 31.3.01 were settled for Rs.2,74,000. Provisions required in respect of 2001-02 is Rs.82,000. How will you show provision for tax in P/L A/c?

Provision for Income Tax A/c

To Tax paid	2,74,000	By balance b/d	3,00,000
To P/L App A/c	26,000		
	3,00,000		3,00,000
		By P/L A/c	8,20,000
To balance c/d	8,20,000		
	8,20,000		8,20,000

Calculation of Managerial Remunertion:

2.From the following particulars of Ganga Ltd calculate the Managerial remuneration assuming there are two whole time directors; a part time director and manager:

Net Profit before provisions for income tax and Managerial remuneration	
But after depreciation	8,70,410
Depreciation provided in the books	3,10,000
Depreciation allowable under schedule XIV	2,60,000

Solution:

Net Proft	8,70,410
Add: Depreciation	3,10,000
	11,80,410
Less: Depreciation u/s XIV	2,60,000

Profit for Managerial Remuneration 9,20,410

Managerial Remuneration = 9,20,410 X 11% = 1,01,245.

2. The following is the profit and loss account of Charles & Rahim Ltd. Calculate
   - (i) The overall maximum remuneration under section 198 and
   - (ii) The maximum commission permissible to directors (a)when not assisted by managing director or manager or whole time director (b) when assisted by a managing director/manager/whole time director.

Profit & Loss A/c

To salaries & wages 4,20,000 By GP 75,75,000

To Directos fees 1,80,000 By Subsidy from Govt 3,60,000

To Repairs & Renewals 1,80,000

By Profit on sale of FA 14,40,000

To Mis. Exp 1,44,000 Cost 24,00,000

To Workmens compensation WDV 12,00,000

Including Rs.30,000 legal

Compensation 75,000

To Loss on sale of investment 3,75,000

To Scientific research 6,00,000

To Compensation for breach

Of contract 36,000

To donation to charitable trust 1,05,000

ToDepreciation(including

development rebate

Rs.75,000 and

initial depreciation Rs.30,000) 6,00,000

To provision for income tax 18,00,000

To proposed dividend 12,00,000

To interest on debentures 1,50,000

To interest on umsecured 30,000

To balance c/d 34,80,000

93,75,000	93,75,000

Solution:

Calculation of Managerial Remuneration of Charles & Rahim Ltd

Remuneration	Rs.	Rs.
Net Proft as per P/L A/c		34,80,000
Add: Expenses debited to P/L A/C but not allowed:		
Workmen's compensation (75000-3000)	45,000	
Loss on sale of investment	3,75,000	
Scientific research	6,00,000	
Development Rebate	75,000	
Initial Depreciation	30,000	
Provision for Income tax	18,00,000	
Proposed dividend	12,00,000	
		41,25,000
		76,05,000
Less: Income credited to P/L A/C but not allowed:		
Capital Profit on sale of fixed assets		2,40,000
		73,65,000

(i) Overall Remuneration: 73,65,000 x 11% = 8,10,150

(ii) Remuneration to Part time Directors when not assisted by others:

73,65,000 x 3% = 2,20,950

(iii) When assisted by others:

73,65,000 X 1% = 73,650

Profit and Loss appropriation account:

3. X ltd had a balance of Rs.1,50,000 in the profit and loss account on 1st April 2005. During 2005-06, its profit before tax amounted to Rs.15,25,000. The income tax provision for the year amounted to Rs.6,95,000. The company decided to transfer Rs.1,20,000 to General Reserve. Rs.1,75,000 to sinking fund for redemption of debentures and to pay a dividend for the financial year at the rate of 10%. The company's share capital consisted of Rs.6,00,000 shares of Rs.10 each. Draw up the profit and loss appropriation account.

Solution:

Profit & Loss Appropriation A/c

To Income tax	6,95,000	By balance b/d	1,50,000
To Transfer to General Reserve	1,20,000	By Net Profit	15,25,000
To Sinking Fund	1,75,000		
To Dividend	6,00,000		
(6,00,000 x 10 x10%)			
To Corporate tax	60,000		
To Net Profit tr to Balance sheet	25,000		
	16,75,000		16,75,000

Final Accounts:

4. The following are the balances of B.B Lal Co Ltd as on 31st Dec 1998.

Debit	Rs.	Credit	Rs.
Cash & Bank balance	2,03,250	Sales	20,75,000
Purchases	9,25,000	General Reserve	1,25,000
Preliminary Expenses	25,000	Creditors	2,00,000
Wages	4,89,900	Bills Payable	1,85,000
General Expenses	34,175	Share Capital	20,00,000
Salaries	1,01,125	12% |Debentures	15,00,000
Bad Debts	10,550	Profit & Loss A/c	1,31,250
Debenture interest paid	90,000	Provision for bad debts	17,500

Premises	15,36,000		
Plant & Machinery	16,50,000		
Stock (1.1.98)	3,75,000		
Debtors	4,35,000		
Goodwill	1,25,000		
Calls-in-arrears	37,500		
Interim dividend paid	1,96,250		
Total	62,33,750	Total	62,33,750

You are required to prepare profit & loss account for the year ended 31st dec 1998 and balance sheet as on that date after taking into account the following adjustments:

(i)Stock on 31st Dec. 1998 was valued at Rs.4,75,000

(ii)Provide depreciation @15% on Plant & Machinery

(iii)Create 5% provision for doubtful debts on debtors.

(iv)Write off Rs.2,500 from preliminary expenses.

(v)Half year's debenture interest outstanding.

(vi)Create provision for taxation @50%

(vii)A claim of Rs.3,000 for workmen's compensation is being disputed by the company.

Solution:

Trading, Profit & Loss Account of B.B. Lal Co Ltd as on 31/12/98

To Opening stock	3,75,000	By Sales	20,75,000
To Purchases	9,25,000	By Closing Stock	4,75,000
To Wages	4,89,900		
To Gross Profit	7,60,100		
Total	25,50,000	Total	25,50,000

To General Expenses		34,175	By Gross Profit	7,60,100
To Salaries		1,01,125		
To Bad Debts	10,550			
Add: Provisions	21,750			
(435000 x 5%)				
	32,300			
Less;Old provision	17,500	14,800		
To Debenture Interst	90,000			
Add: Half years	90,000	1,80,000		
To Depreciation				
Plant		2,47,500		
To Pre.Exp Written off		2,500		
To Provision for IT				
(1,80,000 x 50%)		90,000		
To Net Profit		90,000		
Total		7,60,100	Total	7,60,100

Profit & Loss Appropriation A/c

To Interim Dividend Paid	1,96,250	By Balance b/d	1,31,250
To Corporate tax	19,625	By Net Profit	90,000
To Surplus tr to Balance sheet	5,375		
	221,250		2,21,250

Balance sheet as on 31/12/98

Liablities		Rs.	Assets		Rs.
Authorised capital	20,00,000		Fixed assets:		
Less: Calls in arrears	37,500	19,62,500	Premises		15,36,000
Reserves & Surplus:			Plant	16,50,000	
General Reserve		1,25,000	Less:Deprn	2,47,500	14,02,500
Profit & Loss A/c		5,375	Goodwill		1,25,000
Secured Loans:			Current assets:		
12% Debentures		15,00,000	Cash & Bank		2,03,250
Outstanding interest		90,000	Debtors	4,35,000	
Unsecured loans		------	Less: Provision	21,750	4,13,250
Current Liabilities & Provisions:			Closing stock		4,75,000
Creditors		2,00,000	Loans & advances:		---
Bills Payable		1,85,000	Mis.Exp		
Provision:			Pre.Exp	25,000	
Provision for Income tax		90,000	Less: Written off	2,500	22,500
Corporate tax		19,625			
Total		41,77,500			41,77,500

UNIT-IV

Valuation of Goodwill

Learning Objectives

After reading this lesson you should be able

- Know the meaning, nature, and types of goodwill

- know the need for valuation of goodwill
- Identify the factors affecting the value of goodwill
- Describe the various methods of valuation of goodwill

Introduction

Goodwill may be explained as the aggregate of those intangible attributes of a business which contribute to its superior earning capacity over a normal return on investment. In short goodwill refers to measure of the capacity of a business to earn above the normal profits. It attracts more customers and increases the earning capacity of the firm.

Meaning of Goodwill

Goodwill is the valuable asset for the profitable business otherwise it valueless one. Some of the definitions of goodwill as follow:

"Goodwill is a thing easy to describe, but very difficult to define. It is the benefit and advantage of good name, reputation and connection of a business. It is the attractive force which brings in more customers. It is one thing which distinguishes an old established business from a new business at its first start. Goodwill is composed of a variety of elements. It differ in its composition in different businesses in the same trade,"- Lord Macnaughton.

"When a man prays for goodwill, he payes for something which places him in the position of being able to earn more money than he would be able to do by his own unaided efforts."- Dicksee

"The element of an established business which makes the business as a going concern worth more than its book value, that is, its net worth as shown by the books" – Walton.

"Goodwill is nothing more than the probability that the old customers will resort to the old lance" – Lord Eldon.

According to the Institute of Chartered Accountants of India, goodwill is "an intangible asset arising from business connections or trade name or reputation of an enterprise."

The above definitions reveal that the goodwill is thus the extra saleable value attached to a prosperous business beyond the intrinsic value of net assets. Though, goodwill is an intangible asset, the existence of it can be felt through extra earning power. It is ranked as real assets.

Features of Goodwill

The special features of goodwill as follows:

i. It can be sold only with the entire business or it cannot be sold in part in isolation.

ii. It has the value only when it is transferred from one person to another.

iii. It is nonphysical varies over and above the physical assets.

iv. It cannot have an exact cost and it time to time it will fluctuate.

v. Its value based on the judgement of the valuer.

Nature of Goodwill

Goodwill has been said to be the attractive force which brings in customers. Hence to determine the nature of the Goodwill in any one given case, it is necessary to consider the type of business and the type of customers. The following are the principal classes of Goodwill.

a) **DogGoodwill**: Dogs are attached to the persons. Such customers lead to *personal goodwill* which is not transferable.
b) **Cat Goodwill**: The cat stays in the old home although the person who has kept the home leaves. Such customers give rise to *locality goodwill*.The value of cat goodwill always maximum one.
c) **Rat Goodwill**: The characteristic of a rat is that it moves from place to place. The rat has no attachments and is purely casual. The customer has attachment neither to the person nor to the place.It is known as *fugitive goodwill*. Such goodwill is valueless.
d) **Rabbit Goodwill**: The rabbit is attracted by mere propinquity. He comes because he happens to live close by and it would be more troublesome to go elsewhere.

Types of Goodwill

Goodwill is generally of two types, viz. purchased goodwill and non-purchased or inherent goodwill.

Need for valuation of Goodwill

Circumstances necessitating ascertainment of goodwill are:

In the case partnership firm

1. When there is a change in profit sharing ratio.
2. When a partner is admitted.
3. When a partner has died or retired.
4. When two partnership firms are amalgamated.

5. When a firm is sold to a company.

In the case of a Company

a. When amalgamation and absorption taken place.
b. When sales or purchase take place.
c. When shares are to be acquired by a holding company.
d. When value of share is not quoted in stock Exchange and shares are to be valued for taxation purposes.

Factors affecting Goodwill

The value of goodwill depends upon the conditions of each case. The main factors affecting the value of goodwill are as follows:

1. Profitability:
Profitability of a firm is most important consideration for computation of goodwill. It refers to the profit which the firm is expected to earn in future. Many factors contribute to determine the profitability of the firm they are as follows:

(a) Nature of Goods. Profits depend upon nature of goods. If business deals in articles of daily use, profits are likely to be constant. If more steady or constant profits are, the more is goodwill or vice versa.

(b) Monopolised Business. A monopolised business will have more goodwill as compared to a business in which many rivals can enter the business.

(c) Trade Name.

(d) Risk Involved. Greater the risks involved, the higher the profits are.

(e) Favourable Location and Site.

(f) Possession of Trademarks, Patents and Copyrights.

(g) Access to Supplies.

(h) Skill of Management.

(i) Possession of Exceptional Contracts.

(j) Future Competition.

(k) Money Market Conditions.

(l) Stable PoliticalConditions.

(m) Government Industrial Policy.

(n) Profit Trends.

(o) Capital Required. If two business units earn the same profit with different amounts of capital, the business unit with lesser amount requirement will enjoy more goodwill.

2. Normal rate of return

Normal rate of return means the rate of return that will satisfy ordinary inverts in the industry concerned. It is differ from one industry to another. It comprises of three components:

a. Return at zero risk level. It refers to the expected rate of return of a project involves no risk either business or financial.

b. Premium for business risk. Business risk refers to the variability in operating profits due to change in sales. In such case, the investor expected more return from the investment.

c. Premium for financial risk. Financial risk arises due to the capital structure or debt equity mix of a firm. The higher debt content in the capital structure is more risk compared with low debt content firm.

3. Capital employed

The capital employed is the factor considered for the base for computation of the normal return on investment. It there is any change, which will affect the value of goodwill.

Accounting Treatment

Following are the methods of accounting for goodwill:

(a) Carry it as an asset and write it off over a period of years through the Profit and Loss Account.

(b) Eliminate it against reserves immediately

(c) Retain it an asset with no write-off unless a permanent reduction in value become evident.

(d) Write it off against profits immediately.

(e) Show it as a deductionfrom shareholders' funds which may be amortized or carried forward indefinitely.

Methods of Evaluating Goodwill

The following are the methods of evaluating goodwill:

1. Average Profit Method
2. Super Profit Method
3. Capitalization Method

4. Annuity Method

Average Profit Method

In this method, this goodwill is valued on the basis of an agreed number of years' purchase of the averageprofits. The following factors are to be considered for computation of average profit:

1. Non-operating profit or loss to be excluded.
2. The loss, if any, in any year to be deducted.
3. Deduct such incomes or special incomes which may not be continued in future.
4. Past special types of expenses, which will not incur in future, are added.
5. Provision may be made for managerial remuneration.
6. Depreciation on fixed asset should be provided.

After adjustment the computed average profit is multiplied by a number as agreed. At the time of calculating average profit, precaution must be taken in respect of any abnormal items of profit or loss which may affect future profit. It should be mentioned that average profit may be based on simple average or weighted average.The product will be the value of goodwill.

$$\text{Average Profit} = \frac{\text{Total Profits for all the years}}{\text{Number of Years}}$$

Value of Goodwill = Average Profit x Years of Purchases

Illustration: 1

Mathanmohan and company decided to purchase a business for `1,80,000.Its profit for the last 4years are 2011-12 `40,000:2012-13 `50,000:2013-14 `56,000 and 2014-15 `68,000. The business was looked after by the management. Remuneration from alternative employment, if not engaged in the business, for the management comes to `3,500p.a.

Find out the amount of goodwill if it is valued on the basis of three years' purchase of the average net profit for the last four years.

Salutation:

		Profits `
2011-12		40,000
2012-13		50,000
2013-14		56,000
2014-15		68,000
Total of 4 years Profit:		2,14,000
Average Profit = 2,14,000/4	=	53,500
Less Management Remuneration	=	3,500
Adjusted Profit		50,000

Value of goodwill = 50,000 x 3 = `1,50,000

Super Profit Method

Super profit refers to that average profit which is earned by a business in excess of normal earnings. Really speaking the super profit is the difference between actual average profit and normal profit. That is, the term super profit means the profit over and above the normal profit. Or

Super Profit = Average Profit (Adjusted) – Normal Profit

Value of Goodwill = Super Profit x Years of Purchases

An assumption is made regarding the percentage of profit earned on a certain investment of capital in similar industries. This is considered as the normal expected profit in similar concerns.

This normal profit is compared with the actual profit. When the actual profit is more, there will be goodwill. To arrive at the value of goodwill, the super profit is multiplied by the number of years.

Illustration: 2

Average capital employed in X Ltd. is `30,00,000 whereas net trading profits before tax for the last three years have been `14,60,000, `14,45,000 and `15,20,000. In these three years, the managing director was paid a salary of `5,000 p.m. But now he would be paid a salary of `7,500 per month. Normal rate of return expected in the industry in which X Ltd. is engaged is 20%. Rate of tax is 50%. Calculate goodwill on the basis of two years' purchase of the super profits.

Solution:

Total trading profits for the last three years = `14,60,000 + `14,45,000 + `. 15,20,000 = `44,25,000

	`
Average annual trading profits = Rs. 44,25,000 ÷ 3	14,75,000
Less : Additional salary to managing director = (`7,500 - ` 5,000) x 12	30,000
	14,45,000
Less : Income tax @ 50%	7,22,500
Expected profits	7,22,500

Normal profits = 20% of `30,00,000 = `6,00,000

Super profits = `7,22,500 - `6,00, 000 = `1,22,500

Goodwill on the basis of two years' purchase of super profits = `1,22,500 x 2

= ` 2,45,000

Capitalization of Profit Method

There are two methods under this:

(a) Capitalization of Super Profit

Under this method, it is estimated as to how much capital will be required to earn super profit at normal rate of profit. This capitalized value of super profit is treated as goodwill.

(b) Capitalisation of average profit

Under this method the average annual profit is to be ascertained after providing for reasonable management remuneration. This profit should be capitalized at the rate of reasonable return to find out the total value of the business. Now the value of goodwill will be the total value of the business minus its net assets. If, however, the net assets are greater, there will be no goodwill but bad will.

$$\text{Capitalised Value of Profit} = \frac{\text{Profit (Adjusted)}}{\text{Normal Rate of Return}} \times 100$$

Value of Goodwill =Capitalised Value of Profit – Net Tangible Assets

Illustration:3

The net profits of a company, after providing for taxation, for the past five year are `42,000;`47,000;`45,000; `39,000 and `. 47,000. The capital employed in the business is `4,00,000 on which a reasonable rate of return of 10% is expected. Calculate the goodwill under (a) Capitalisation of average Profit Method and (b) Capitalisation of Super Profit Method.

Solution:

(a) Average Profit = Total profit of 5 years/ 5

= (`42,0000 + `47,000 + `45,000 +`39,000 + `47,000)/ 5

= `.2,20,000 / 5
= `44,000

$$\text{Capitalised value of the business at 10\%} = \frac{`44{,}000 \text{ x}100}{10} = `4{,}40{,}000$$

Less: Capital employed (given)	`4,00,000
Value of goodwill:	40,000
(b)Average Profit (as above)	`44,000
Less: normal return on capital employed	
(At 10% on Rs 4,00,000)	` 40,000
Super Profit	`4,000

$$\text{Capital value of super profit} = \frac{4{,}000 \text{ x } 100}{10} = `\ 40{,}000$$

Annuity Method

This method is based on the logic that the purchaser should pay now for goodwill only the present value of super profits calculated at a proper rate o interest. In other words, goodwill in case of this method is the discounted value of the total amount calculated as per purchase of super profit method.

The value of goodwill in case of this method is ascertained as follows:

Average Annual Super Profit × Annuity Rate

Illustration:4

Calculate the value of Goodwill for thefollowing data on the basis of aunity method:

Average annual super profit	`5,000
Rate of interest	10%

Goodwill is to valued at 3 year purchase of the average annual super profit

Solution:

In case goodwill is to be valued at 3 years' purchase of the average annual super profit reference will have to be made to the annuity table for finding out the present value of one rupee paid annually for 3 years at 10% interest. Reference to annuity table shows that `2.48685 is the present value of an annuity of `1 for three years. The value of goodwill will, therefore, be ascertained as follows:

` 5,000 × 2.48685 = ` 12,434 or (say) ` 12,500.

Illustration:5

Balance Sheet of Mr. X as as on 31stMarch 2014 was as under:

Capital	2,50,000	Land	1,80,000
Creditors	80,000	Machinery	1,10,000
Bills Payable	20,000	Furniture	2,000
		Stock	8,000
		Cash at Bank	50,000
	3,50,000		3,50,000

The profit of the business for the five years ending 31st March 2014 are:

	`
31st March 2010	40,000
31st March 2011	42,000
31st March 2012	45,000
31st March 2013	50,000
31st March 2014	53,000

The assets are revealed as under:

	`
Land	1,94,000
Machinery	1,18,000
Furniture	1,000

The reasonable return on capital invested is 10% p.a.

Assume that normal management remuneration is ` 6,000.

Find out goodwill by capitalization method.

Solution:

Average profit = (Total Profits of 5 years)/5
= 2,30,000 / 5 = 46,000
Less: Remuneration = 6,000
Average Profit 40,000

Calculation of normal capital by capitalisation of average profit
= (40,000 x 100)/10 = `4,00,000

		`
Land		1,94,000
Machinery		1,18,000
Furniture		1,000
Stock		8,000
Cash		50,000
Total Assets		3,71,000
Less: Liabilities		
Creditors	80,000	
B/P	20,000	1,00,000
Net assets (capital Employed)		2,71,000

Good will = Normal Capital – Actual Capital Employed
= `4,00,000 – `2,71,000 = `1,29,000

Capitalization of super profit:

Average Profit	` 40,000
Less: Normal Profit: 10% on ` 2,71,000	` 27,100
	12,900

Goodwill = `12,900 x 100/10 = 1,29,000

Illustration:6

Ram runs a chemist shop. His net assets on March 31, 2014 amount to `20,00,000. After paying a rent of `20,000 a year and salary of `20,000 to the chemist, he earns a profit of `1,50,000. His landlord, who happens to be an expert chemist, is interested in purchasing the shop 12% is considered to be a reasonable return on capital employed. What can Ram expect as payment for goodwill?

Solution:

	`
Profit earned by Ram	1,50,000
Add: Rent, no more to be paid	20,000
Add: Chemist salary, no more to be paid	20,000
	1,90,000
Less: Reasonable remuneration for the new propriater assumed	25,000
adjusted profit:	1,65,000
Capital employed amounted to:	20,00,000
Add: Value of buildings, now form part of the capital (assume)	2,00,000
	22,00,000
Normal Profit @ 12% on ` 22,00,000	2,64,000
Adjusted profit	` 1,65,000
Less: Normal Profit	` 2,64,000
	NIL

Since, there is no super profit, there will be no goodwill.

Illustration:7

The following is the Balance-Sheet of Quality Traders Ltd., as at 31st March 2015:

BALANCE SHEET

Liabilities	`	***Assets***	`
Share capital	3,28,000	Fixed assets	1,80,000
Reserve	80,000	Current assets	2,44,080
Creditors	76,080	Investment in shares	60,000
	4,84,080		4,84,080

The following net profits were earned which included a fixed income from investment of ` 4,000 p.a:

Year ended 31st March, 2012	`64,000
Year ended 31st March, 2013	72,000
Year ended 31st March, 2014	86,000
Year ended 31st March, 2015	90,000

Standard rate of return on capital employed in such type of business is 8%.

Compute the amount of goodwill of the above business at three years* purchase of the average super profits for four years assuming that each year's profit was fully distributed as dividend among the shareholders.

Solution

Average profit.

Since the profits are showing increasing trend, a weighted average is preferable.

Year	***Operating Profits*** `	***Weight***	***Product*** `
Year ended 31st March, 2012	60,000	1	60,000
Year ended 31st March, 2013	68,000	1.5	1,02,000
Year ended 31st March, 2014	82,000	2	1,64,000
Year ended 31st March, 2015	86,000	2.5	2,15,000
		7	5,41,000
Average profit		*(A)*	77,286
Capital employed: Fixed assets			1,80,000
Current assets			2,44,080
			4,24,080
Less: Sundry creditors			76,080
			3,48,000
Add: ½ of the Average profit			38,643
Average capital employed			3,86,643
Return on capital employed @ 8%		*(B)*	30,931
Super profits *(A)-(B)*			46,355
Goodwill at 3 years' purchase			1,39,065

Illustration:8

The Balance Sheet of Toy Gun Manufacturing Co. Ltd. discloses the following financial position as at 31st March, 2013.

Liabilities	`	***Assets***	`
Paid-up capital:		Goodwill at cost	30,000
30,000 shares of ` 10 each		Land and buildings at cost	
fully paid	3,00,000	(*Less:* Depreciation)	1,75,000
Capital reserve	60,000	Plant and machinery at cost	
Sundry creditors	71,000	(*Less:* Depreciation)	90,000
Provision for taxation	55,000	Stock at cost	1,15,000
Profit and loss A/c	26,000	Book debts 98,000 *Less:* Provision for	
		doubtful debts 3,000	95,000
		Cash at bank	7,000
	5,12,000		**5,12,000**

You are asked to value the goodwill of Toy Gun Manufacturing Co. Ltd. for which purpose the following information is supplied:

a) Adequate provision has been made in the accounts for income-tax and depreciation.
b) Rate of income-tax may be taken at 50%.
c) The average rate of dividend declared by the company for the past five-years was 15 per cent.
d) The reasonable return on capital invested in the class of business done by the company is 12 per cent.

Solution: **VALUATION OF GOODWILL**

1. Super Profit Method	
Capital employed:	`
Tangible assets:	
Land and buildings	1,75,000
Plant and machinery	90,000
Stock	1,15,000
Book debts	95,000
Cash at bank	7,000
	4,82,000
Less: Sundry creditors 71,000	

Provision for taxation	55,000	1,26,000
Capital employed		3,56,000
Normal profit @ 12 per cent		42,720
"Actual profit after tax		55,000
Super profit (`55,000 - ` 42,720)		12,280
Goodwill at say 4 years' purchase		49,120
2. Capitalization of Profits Method		`.
Total value of business	55,000 × 100 ÷ 12	4,58,333
Less: Net tangible assets (as above)		3,56,000
Goodwill		1,02,333

*Profit during the year is assumed to be equal to the Provision for Taxation since the rate of income-tax is 50 per cent. Tax figure of ` 26,000 in the Profit and Loss Account seems to be only the balance left in this account after payment of dividend.

Self Test Questions Theory

1. What are the different methods of employed for valuation of goodwill?
2. Explain with an illustration the significance of the capitalisation of profit method?
3. Define goodwill and point out its principles of calculation?
4. What is the importance of goodwill?
5. Define goodwill. Is it real or fictitious?

Problems

1. Find out goodwill by capitalization method from the following information: normal rate of return 10%; Profit for the last three years are `.30,000; `. 40,000 and `.50,000. Non recurring income of `. 3,000 is included in the above mention profit of `., 30,000. Capital employed is `.3,00,000.

2. The following information is given (a) Average capital employed `1,00,000, (b) Present value of the annuity of `1 for 5 years at 10% is `3.78, (c) Normal rate of profit is 10% (d) Net profits for five years are: I year ` 15,000; II year `16,000; III year ` 17,000 IV year ` 18,000 and V year `20,000.

Profits included non recurring profit on an average basis of `1,500 out of which `300 had the recurring tendency. Remuneration of proprietor is ` 800 p. a which is not charged in profit and loss. Find out goodwill (a) as per 5 years' purchases of super profit, (b) as per annuity method (c) as per capitalization of profit method.

3. The following particulars are available in respect of the business carried on by a traders:

1) Profits earned : 2011-12` 50,000; 2012-13`60,000: 2013-14`55,000
2) Normal Rate of profit 10%
3) Capital Employed `.3,00,000
4) present value of an annuity of one rupee for five years at 10% ` 3.78
5) The profits included non- recurring profits on an average basis of `.4,000 out of which it was deemed that even non- recurring profits had a tendency of appearing at the rate of ` 1,000p.a

You are required to calculate Goodwill:

(a) As per five years purchase of super profit:
(b) As per capitalization of super profit method
(c) As per annuity method

4. Following information are available about the business of Sudhir Ltd.

(i) Profits: in 2002 `. 40,000; in 2003 `.50,000; in 2004 `.. 60,000.
(ii) Non-recurring income of `4,000 is included in the profit of 2003.
(iii) Profits of 2002 have been reduced by `.6,000 because goods were destroyed by fire.
(iv) Goods have not been insured but it is thought to insure them in future. The insurance premium is estimated at `.4000 per year.
(v) Reasonable remuneration of the proprietor of business is `.6,000 per year, but it has not been taken into account for calculation of above mentioned profits.
(vi) Profit of 2004 included `.5,000 income on investment. Calculate Goodwill on the basis of two years purchase of the average profit of last three years.

5. Ascertain the value of Goodwill of Pai and Company, carrying on business as retail traders from the following information:

Balance sheet as on 31st March 2012

	`		`
Paid up Capital:		Goodwill	25,000
2,5000 shares of Rs 100 each	2,50,000	Land & Building (as cost)	1,10,000
		Plant (at cost)	1,00,000
Profit and loss A/c	56,650	Stock at cost	1,50,000
Bank over draft	58,350	Book debts	90,000
Sundry creditors	90,500		
Provision for taxation	19,500		
	4,75,000		4,75,000

The company commenced operation in 2010-11 with a paid up capital as aforesaid of ` 2,50,000. The profits earned, before providing for taxation, have been as follows:

2010-11` 61,000 2011-12` 64,000 2012-13` 71,500

2013-14` 78,000 2014-15` 85,000

You may assume that income tax at the rate of 50% has been payable on these profits. The average dividend paid by the company for the four years is 10% which is taken as reasonable return expected on the capital invested in the business.

6. The Balance sheet of Ram Ltd as on 31st March 2012

Liabilities	`	Assets	`
8% 5,000 shares of `10 each	50,000	Goodwill	10,000
10,000 shares of ` 10 each	1,00,000	Fixed Assets	1,80,000
Reserves (including provisions for taxation `10,000)	1,00,000	Investments (5% Govt. loan)	20,000
		Current Assets	1,00,000
8% Debentures	50,000	Preliminary Expenses	10,000
Creditors	25,000	Discount on 8% Debentures	5,000
	3,25,000		3,25,000

The average profit of the company (after deducting interest on debentures and taxes) is `31,000. The market value of machinery included in fixed assets is ` 5,000 more. Expected rate of return is 10%. Evaluate the goodwill of the company at five times of the super profits.

7. The following is the balance sheet of Krishna Ltd as on 31st March 2014

Liabilities	`	Assets	`
Paid up Capital		Land and Building	7.80.000
12,000 shares of `100 each	12,00,000	Plant and machinery	3,00,000
General Reserves	1,60,000	Sundry Debtors	2,20,000
Profit and Loss A/c	1,00,000	Bills receivables	60,000
Sundry Creditors	80,000	Stock in trade	1,20,000
Bills payable	40,000	Goodwill	40,000
		Government Securities at 10%	60,000
	15,80,000		15,80,000

Company earned net profits for the past four years as follows:

2010 – 11 - ` 1, 00,000

2011 – 12 - ` 2, 00,000

2012 – 13 - ` 3, 00,000

2013 – 14 - ` 4, 00,000

The value of Goodwill should be computed at three years purchase of the average super profit for the four years.

Valuation of Shares

Learning Objectives

After reading this lesson you should be able to

- know the need for valuation of share
- Identify the factors affecting the value of share
- Describe the various methods of valuation of share
- Compute the value of share

Introduction

A share represents an interest in a company. The term “value of share” has different meaning. The “Face value” of a share specified in the memorandum of association of the Joint Stock Company, which is fixed in nature. The listed company’s shares are quoted in stock exchange at market price known as “Market value”, which is determined by market forces of demand and supply. The shareholders are interested in dividend and the realisable value of their holdings. The value of a share of a company may be valued in number of ways. On the basis of the reasons this may be vary. The valuation of shares is not only meant of the public limited company but also for the private company as and when need raised.

Need for Valuation

Valuation of shares assumes significance in the following cases:

1. Amalgamation or absorption of companies
2. Conversion of shares of one class into another
3. Purchase and sale of controlling shares
4. Shares as security for loans and advances
5. Assessment of estate duty, wealth tax etc.
6. Unquoted shares in the exchange
7. To satisfy dissentient shareholders
8. Nationalisation of companies
9. To satisfy dissentient shareholders
10. In case of trust finance or investment trust companies

Factors affecting value of shares

The factors affecting value of shares are similar to those factors which affect the value of goodwill. They are as follows:

1. Nature of the company’s business

2. Percentage of dividend declared on the shares
3. Demand and supply of shares
4. Company's earnings capacity
5. Price level changes
6. General economic conditions
7. Restrictions on investment
8. Net tangible asset of company
9. Nature of competition and market share
10. Financial, Political and other factors affecting the business
11. Type of management
12. Goodwill of company
13. Capacity of director

Methods of Valuation of Shares

The share can be valued either as an interest in the net assets of the company or as an entitlement to a share of future profits. In this view, the following are the methods for valuation of shares.

1. Net Asset Method (Intrinsic value)
2. Yield Method
3. Earning Capacity

Net Asset Method

This is also known as Balance Sheet Method or Intrinsic Method or Break-up Value Method or Valuation of Equity basis or Assets Baking Method. Here the emphasis is on the safety of investment as the investors always need safety for their investments. In this method, the value of the net assets of the company against each shares are t be arrived. The following points may be become in mind:

1) The fixed assets of the company should be revalued at their net realisable values.
2) Floating assets are to be taken at market value.
3) All fictitious assets, such as Preliminary Expenses, Accumulated Losses etc. are to eliminated.
4) The goodwill will be ascertained on the appropriate basis.
5) Provision for depreciation, bad debts provision etc. must be considered.

6) Find out the external liabilities of the company payable to outsiders including contingent liabilities.

7) All unrecorded assets and liabilities are to be taken into consideration.

Thus the value of net asset is:

Total of realisable value of assets – Total of external liabilities = Net Assets (Intrinsic value of asset)

Value of equity share = Net assets – Preference share capital

$$\text{Value of equity share} = \frac{\text{Net assets – Preference share capital}}{\text{Number of Equity Shares}}$$

Illustration: 1

From the following information compute the 'Intrinsic Value' of an Equity share of Joy Ltd. Balance Sheet as at 31 .3. 2014.

Liabilities	`	Assets	`
2,000 Equity shares of ` 100		Land & Building	2,00,000
each, fully paid-up	2,00,000	Plant & Machinery	80,000
1000, 6% Preference shares of		Sundry Debtors	55,000
`100 each, fully paid	1,00,000	Stock	70,000
Reserve & Surplus	25,000	Cash at Bank	25,000
1000, 5% Debentures of		Investment in	
` 100 each	1,00,000	5% Govt. Securities	10,000
Sundry Creditors	10,000	Cash in hand	10,000
		Preliminary Expenses	5,000
	4,55,000		4,55,000

i. Fair return on capital employed in this type of business is around 10% p.a.

ii. Goodwill is to be taken at 5 'years' purchase value of super profit.

iii. Average of the profits (after deduction of Preliminary expenses) for the last seven years is `43,000. Preliminary expenses to the extent of ` 1,000 have been written-off every year for the last seven years. Profit is more or less stable over years and the same trend is expected to be maintained in the near future. Ignore tax.

SOLUTION:

Computation of Goodwill .

Capital Employed :		
Land & Building		2,00,000
Plant & Machinery		80,000
Sundry Debtors		55,000
Stock		70,000
Cash at Bank		25,000
Cash in hand		10,000
		4,40,000
Less: Liabilities:		
5% Debentures	1,00,000	
Creditors	10,000	1,10,000
Capital Employed:		3,30,000

Normal Profit =`3,30,000 x 10/100 = ` 33,000

Super Profit

Average Profit	` 43,000
Less: Non-trading income	
Interest on Investment@ 5% on Rs. 10,000	500
	42,500

Super Profit = Average Profit – Normal Profit = `42,500 – `33,000 = `9,500

Value of Goodwill = ` 9,500 x 5 = ` 47,500

Valuation of Shares:

Total Assets (as above)	` 3,40,000
Add: Investment	10,000
Add: Goodwill	47,500
	3,97,500

Less: Liabilities (as above)	1,10,000
	2,87,500
Less: Preference Share Capital	1,00,000
Funds available to equity shareholders	2,87,500

$\Rightarrow$ Intrinsic value a Equity Share $= \dfrac{`2,87,500}{2,000} = 143.75$

Illustration:2

The following is the balance sheet of Shan Company Ltd. as on March 31, 2014.

Liabilities	`	Assets	`
3,000 Equity shares of		Cash in hand	2,000
`100 each 1,500,	3,00,000	Cash at Bank	20,000
8% Preference share		Sundry Debtors	80,000
Capital of ` 100 each	1,50,000	Stock in trade	1,40,000
General Reserve	40,000	Land & Building	2,05,000
Profit & Loss A/c	10,000	Furniture	30,000
Bank Loan	50,000	Goodwill	70,000
Sundry Creditors	15,000	Discount on Shares	18,000
	5,65,000		5,65,000

The value of assets is assessed as follows:

1. Furniture to be depreciated at 10%
2. Value of stock-in-trade, land and building and goodwill is estimated at ` 1,20,000, `2,50,000 and ` 80,000 respectively.
3. Debtors are expected to realise 80% of book value. Find out the value of equity shares.

SOLUTION:

Reserved Value of Reliable Assets:	`
Cash in hand	2,000
Cash at Bank	20,000
Sundry Debtors	64,000
Stock in trade	1,20,000
Land & Building	2,05,000
Furniture	27,000
Goodwill	80,000

		5,63,000
Less: Liabilities:		
Bank Loan	50,000	
Sundry Creditors	15,000	65,000
Net Assets		4,98,000
Less Preference Share Capital		1,50,000
Assets backed by Equity Share Capital		3,48,000

No. of equity shares is 3,000

Intrinsic value of each equity share is $\frac{3,48,000}{3,000}$ = ` 116

Illustration:3

The following is summarised Balance Sheet of Mathi Co. Ltd. as on 31.03.2014.

Liabilities	`	Assets	`
Authorised, Issued, Subscribed Capital:		Goodwill	5,000
1,000 Equity shares of `.100 each fully paid	1,00,000	Land & Building	1,05,000
1,000 Redeemable Pref. Shares of `100 each fully paid	1,00,000	Machinery	55,000
General Reserve	15,000	Stock (at cost)	45,000
Dividend Equalisation Reserve	5,000	Sundry Debtors	20,000
Employees' Compensation Fund (represented by Investment in securities)	5,000	Cash in hand	5,000
Provision for Taxation	5,000	Cash at Bank	1,15,000
Employees' Saving Account	10,000	Investment in National Plan certificate	5,000
Sundry Creditors	20,000	Preliminary Expenses	5,000
Profit & Loss A/c	1,00,000		
	3,60,000		3,60,000

On 1.4.2014, all the Preference shares were redeemed at a premium of `10 per share out of profits otherwise available for dividends.

You are asked to ascertain the intrinsic value of each of the Equity shares by Assets Banking Method, on the Balance Sheet immediately after redemption of preference shares.

Take into account the following information:

i. Goodwill to be taken at `50,000

ii. 10% of Sundry are bad;

iii. A claim for compensation to an employee has been admitted on 1.4.2014, for ` 1,000;

iv. All the other assets are taken at their book values as shown in the above Balance Sheet.

SOLUTION:

		`
Net Assets:		
Goodwill		50,000
Land & Building		1,05,000
Machinery		55,000
Stock		45,000
Sundry Debtors (` 20,000 – ` 2,000)		18,000
Investment		5,000
Cash in hand		5,000
Cash in Bank		5,000
(` 1,15,000 – ` 1,10,000 for payment Pref. Shareholders with premium)		2,88,000
Less: Current Liabilities:		
Employees' Savings Account	10,000	
Sundry Creditors	20,000	
Employees' Compensation Claim	1,000	
Provision for Taxation	5,000	36,000
Funds available for Equity shareholders		2,52,000

$\Rightarrow$ Intrinsic value of each Equity Share = $\dfrac{\text{` } 2{,}52{,}000}{1{,}000}$ = **` 252**

Illustration:4

The following sheet of ABC Ltd. as at 31st March 2014 was as follows:

	`		`
Equity shares (` 10)	5,00,000	Goodwill	1,00,000
General Reserve	2,50,000	Equipment at cost	9,00,000
Profit & Loss A/c	1,00,000	Stock	3,50,000
12% Debentures	3,00,000	Debtors	1,50,000
			75,000

Provisions for Depreciation	1,50,000	Bank	
on equipment	40,000	Advertisement	25,000
Staff Welfare Fund	75,000	Suspense Account	
Proposed Dividend	1,85,000		
Sundry Creditors	16,00,000		16,00,000

You are required to calculate the value of each equity share under assets basis.

The following further information is available:

i. A fair after-tax return on capital employed for this type of business is 18%.
ii. Equipment is to be revealed at `8,00,000.
iii. Stocks are consider to have a net realisable value of ` 3,30,000.
iv. Goodwill in this type of business is normally valued at years' super profits.
v. Included in the debtors is a balance of ` 10,000 which may prove irrecoverable.
vi. Profits for the last three years (before interest and taxes) are: 2013-14 – ` 5,40,000;
vii. Company profits are taxed at 40 per cent.

SOLUTION:

Computation of Goodwill

	`	`
Capital Employed:		
Equipment	8,00,000	
Stock	3,30,000	
Debtors, Less Provision (`1,50,000 – ` 10,000)	1,40,000	
Bank	75,000	13,45,000
Less: Current Liabilities		
Sundry Creditors	1,85,000	
Proposed Dividend	75,000	2,60,000
		10,85,000
Normal profit @ 18% on Rs 10,85,000	=	`1,95,300
Average Profit = (` 5,10,000+ ` 5,10,,000 + ` 5,50,000)/ 3	=	`. 5,23,333
Less: Income-Tax @ 40%		2,09,333
Average Profit (after tax)		3,14,000

Super Profit = Average Profit – Normal Profit= `. 3,41,000 – `1,95,300

= `1,18,700

Value of Goodwill = `. 1,18,700 x 3 = `. 3,56,100

Computation of Net Asset

	`
Net Assets (calculated as above)	10,85,000
Add: Goodwill	3,56,100

	14,41,100
Less: 12% Debentures	3,00,000
Funds available for equity shareholders	11,41,100

$$\text{Intrinsic Value of each equity share} = \frac{\text{Funds available for equity shareholders}}{\text{Total number of equity shares}}$$

$$= \frac{\text{Rs. } 11{,}41{,}100}{50{,}000} = \text{`}.\ 24.32$$

Intrinsic value each equity share (Cum-Dividend)
= 22.82 + `. 1.50 (i.e. ` 75,000 / 50,000 shares) = ` 24.32

Note:

1. Staff Welfare Fund is not a current liability, it is an appropriation of profit.
2. Advertisement Suspense account is a fictitious asset and hence exclude.
3. Debenture Interest is not added with average profit since it has been assumed as part of capital employed and it is engaged in the business for long period of time.
4. Profit for 2013-14

Profit for 2013-14	5,40,000
Less; Value of stock reduced (` 3,50,000 – `. 3,30,000)	20,000
	5,20,000
Less: Provision for Bad Debts	10,000
	5,10,000

3.2.4.2Yield Method

Under the yield method, yield expected by the investors on their investment have considered. The yield denotes the possible return that an investor may get out of his holdings viz. dividend, bonus shares and right issue. If the return is more, the price of share is also more. The following formula is used to calculate the value of a share.

Calculation of Expected Return:

$$\text{Expected Return} = \frac{\text{Expected Profits}}{\text{Equity Capitals}}$$

Calculation of Yield value of Shares:

$$\text{Value of Share} = \frac{\text{Expected Rate}}{\text{Normal Rate}} \times \text{Paid up value of shares}$$

Illustration:5

On the 31st March 2014, the Balance Sheet of Srivatsan Limited Company disclosed the following positions:

Liabilities	`	Assets	`
Issued Capital in shares of `10 each	40,00,000	Fixed Assets Current Assets	5,00,000 2,00,000
Reserve	90,000	Goodwill	40,000
Profit & Loss	20,000		
5% Debentures	1,00,000		
Current Liabilities	1,30,000		
	7,40,000		7,40,000

On 31st March 2014the fixed assets were independently valued at ` 3,50,000 and the goodwill at ` 50,000. The net profits for the three years were:

2011-12 ` 51,600; 2012-13 ` 52,000 and 2013-14 ` 51,650 of which 20% was placed to reserve account and this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%. Compute the value of the company's sahre by (a) the assets method and (b) the yield method.

SOLUTION:

(a) Value of shares according to the Assets method:`

Current Assets as per Balance Sheet		2,00,000
Revalued fixed Assets		3,50,000
Revalued goodwill		50,000
		6,00,000
Less: Liabilities: 5% Debentures	1,00,000	
Current Liabilities	1,30,000	2,30,000
Net Assets		3,70,000

$$\text{Intrinsic value per share} = \frac{\text{Net Assets}}{\text{No. of Equity shares}}$$

$$= \frac{3,70,000}{40,000} = \text{` } 9.25$$

(b) Value of shares according to Yield Method
Calculation of average expected future profits:
Profit for 2011-12 ` 51,000

Profit for 2012-13	` 52,000
Profit for 2013-14	` 51,650
	1,55,250

Average Profit = 1,55,250/3	=	` 51,750
Less: 20% transferred to Reserve	=	10,350
Average Profit after reserve		41,400

Calculation of Expected Return = (Expected Profits x 100) / Equity Capital

= (41,400 x 100)/ 4,00,000 = 10.35%

Calculation of Yield value of share = $\frac{\text{Expected Rate x Paid up value of share}}{\text{Normal Rate}}$

= $\frac{10.35}{10}$ x 10 = ` 10.35

Illustration:6

From the following information, find out the value of each share:

Balance Sheet of Ramgopal Company Ltd.

Liabilities	`	Assets	`
Share Capital:		Fixed Assets:	
20,000 Equity shares of			
`10 each	2,00,000	Goodwill	1,90,000
Reserve & Surplus:		Investment	3,00,000
Reserve	2,50,000	Current Assets, Loans &	
Profit & Loss A/c	30,000	Advances:	
Unsecured Loans	80,000	(a) Current Assets	50,000
Current Liabilities	20,000	(b) Loans & Advances	30,000
		Misc. Expenditure	10,000
	5,80,000		5,80,000

For the purpose of valuation of shares goodwill shall be taken at two years' purchase of the average profit of the last five years. The profits for the last five years are: ` 60,000; `70,000; ` 40,000; ` 50,000 and ` 50,000.

SOLUTION:

Total Profits = ` 60,000 + `. 40,000 + ` 50,000 + `. 50,000 = `. 2,70,000

Average Profits	= (2,70,000)/ 5		= 54,000
Goodwill	= 54,000 x 2		= 1,08,000
Investments			= 3,00,000
Current Assets		50,000	
Loans & Advances		30,000	80,000
			4,88,000
Less: Unsecured Loans	80,000		
Current Liabilities	20,000		1,00,000
			3,88,000

Value of one equity share = $\frac{3,88,000}{20,000}$ = **`.19.40**

Alternative Method

	`
Capital	2,00,000
Add: Reserves	2,50,000
Add: Profit	30,000
	4,80,000
Less: Reduction in value of goodwill & Misc. Expenditure	92,000
	3,88,000

$$\text{Value of one equity share} = \frac{3{,}88{,}000}{20{,}000} = \text{`}.\ \mathbf{19.40}$$

	`
@ Goodwill as per Balance Sheet	1,90,000
	1,08,000
Revalued amount of goodwill	82,000
	10,000
Misc. Expenditure	92,000

Valuation of Right Shares

According to Sec. 81 of the Companies Act, 1956, a company, if it so desires, can increase its share capital by issuing new shares. In that case, the existing shareholders must be given the priority of purchasing those shares according to their paid-up value. Since the existing shareholders have got such right to purchase the newly issued shares, they are called *Right Shares.*

In order to make a proper valuation of right relating to right shares, the market value of the old holdings and the total issue price of new holdings must be added and the same must be divided by the total number of new and old holdings. Value of right will be the difference between the result that is obtained and market value of shares. Hence,

$$\text{Value of Right} = \frac{\text{Number of Right Shares}}{\text{Total Holdings (i.e. holdings = Old + New)}} \times (\text{Market Value} - \text{Issue Price})$$

Illustration:7

The face value of the equity share of a company is ` 10 and the current market price ` 17. The company issues "Right" shares at the rate of 3 Equity shares for every 5 existing Equity shares held, the : “Right” shares being priced at `13. Calculate the value of “Right”

Solution:

$$\text{Value of Right} = \frac{\text{No. of Right Shares}}{\text{Total Shares (old + new holdings)}} \times (\text{Market Value} - \text{Issue Price})$$

Value of Right = 3 / (5 + 3) x (` 17 – `13)

= 3/8 x ` 4 = ` **1.50**

Alternatively

Market value of 5 existing holdings = ` 17x 5 = ` 85

Add: Issue price of 3 new holdings = ` 13 x 3 = ` 39

Value of holding = `124

Value of each share = `124/8 = `15.50

Value of Right = ` 17.00 – `. 15.50 = **`. 1.50**

Illustration:8

The following is the balance sheet of X co. Ltd. as on 31.3.2014

Liabilities	`	Assets	`
Share Capital:		Goodwill	50,000
Equity shares of `. 10 each	1,00,000	Building	1,50,000
12% Pref. Shares of ` 100 each	1,00,000	Plant	1,00,000
General Reserve	60,000	Investment in 10% stock	
Profit & Loss A/c	40,000	(Market value of 52,000;	
15% Debentures	1,00,000	Normal value `50,000)	48,000
Creditors	80,000	Stock	60,000
		Debtors	40,000
		Cash	10,000
		Preliminary Expenses	22,000
	4,80,000		4,80,000

According the value of each equity share under Fair Value Method on the basis of the information given below:

Assets are revalued as follows:

Building	`. 3,20,000
Plant	`. 1,80,000
Stock	` 45,000 and
Debtors	`. 36,000

Average profit of the company is `1,20,000 and 12(1/2)% of profit in transferred to general reserve. Rate of taxation being 50%. Normal dividend expected on equity shares is 8% whereas fair return on capital employed is 10%. Goodwill may be valued at 3 year's purchase of super profit.

Solution:

Computation of Goodwill

	`
Total Net Assets	
Building	3,20,000
Plant	1,80,000
Stock	45,000
Debtors	36,000
Cash	10,000
	5,91,000
Less: Current Liabilities	
Creditors	80,000
Capital Employed	5,11,000

⇨ Normal Profit `. 51,100 [i.e. `. 5,11,000 x 10/100]

Actual Profit

		`.
Average Profit		1,20,000
Less: Non-trading Income		
(i.e. income from investment)	@ 10% on `. 50,000	5,000
		1,15,000
Add: Debenture Interest		15,000
		1,30,000
Less: Pref. Dividend		12,000
		1,18,000
Less: Taxation @ 50%		59,000
		59,000
Less: Transfer to Reserve @12(1/2) %		7,375
		51,625

Super Profit = Actual Profit – Normal Profit
= `. 51,625 – ` 51,100
= `. 525

Value of goodwill = ` 525 x 3 = `.1,575 or `.1,600

Valuation of Shares

Asset-Backing Method

	`
Sundry Assets (as above)	5,11,000
Add: Investments	48,000
Add: Goodwill	1,600
Funds available for Equity shareholders	5,60,000

$$\text{Intrinsic value of share} = \frac{\text{` } 5,60,600}{10,000} = \text{`}.\ \mathbf{56.06}$$

Yield-basis

$$\text{Value of share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of return}} \times \text{Paid up value of each share}$$

= 8/10 x Rs.10 = ` **8**

Fair Value

Fair Value = (Insurance value + yield Basis)/2

= (` 56.66 + `. 8.00)/2 = ` **32.03**

Illustration:9 From the following particulars calculate the value of share of Z Ltd., on yield basis:

Balance Sheet of Z Ltd., *as on 31st March, 2014*

Liabilities	`	***Assets***	`
8,000 Equity shares of Rs.100 each	8,00,000	Land & Building	5,00,000
4,000 10% Preference shares of		Plant & Machinery	6,00,000
` 100 each	4.00,000	Patents	2,00,000
6% Debentures	2.00,000	Sundry debtors	3,00,000
Reserves	4.00,000	Work-in-progress and stock	5,00,000
Sundry creditors	4.00,000	Cash at bank	1,00,000
	22,00,00		**22,00,000**

Land and building to be valued at ` 9,00,000. The company's earnings were as follows:

Year	***Profit (loss) before tax*** *( )*	***Tax*** *( )*
2009-10	3,00,000	80,000
2010-11	4,00,000	1,60,000
2011-12	(1,00,000)	40,000 (Strike)
2012-13	5,00,000	2,30,000
2013-14	5,50,000	3,00,000

The company paid managerial remuneration of ` 60,000 per annum but it will become ` 1,00,000 in future. There has been no change in capital employed. The company paid dividend of ` 9 per share and it will maintain the same in future. The company proposes to build up a plant rehabilitation reserve. Dividend rate in this type of company is fluctuating and the asset backing of an equity share is about 1*1/2*times. The equity shares with an average dividend of 8% sell at par.

Solution

(*i*)Computation of average maintainable profits:

Year	*Profits* `	Weight	*Product* `
2009-10	3,00,000	1	3,00,000
2010-11	4,00,000	2	8,00,000
2011-12	—	—	—
2012-13	5,00,000	3	15,00,000
2013-14	5,50,000	4	22,00,000
		10	48,00,000

Weighted average profits: ` 48,00,000 ÷ 10 = ` 4,80,00

Notes:

(a) Since the profits are showing a definite trend, weights have been given. (b) The loss of the year 2005 has not been considered since it is an abnormal year.

(*ii*)Computation of profits available for dividend: `

Weighted average profits	4,80,000
Less: Increase in managerial remuneration	40,000
	4,40,000
Less: Tax (50% assumed)	2,20,000
Profit available for distribution	2,20,000
Less: Rehabilitation reserve (15% assumed)	33,000
	1,87,000
Less: Dividend on preference shares	36,000
Profit available for distribution to equity shareholders	1,51,000

(*ii*)Asset backing per equity share:

Total Assets as per Balance Sheet		22,00,000
Add: Increase in value of land & building		4,00,000
		26,00,000
Less: Sundry creditors	4,00,000	
6% Debentures	2,00,000	
9% Pref. capital	4,00,000	10,00,000
Net Asset available for equity Shareholders		16,00,000
Equity Share Capital		8,00,000
Asset backing		2 Times

(*iv*)Dividend rate:

Normal dividend rate		8.0%
Less: For higher dividend rate (9%) and stability	(say)	0.5%
Less: For higher asset backing (2 times as compared to 1.5)	(say)	0.5%

(*v*) Capitalization factor: 100 ÷ 7 = 14.286

(*vi*)Value of an equity share:

$$\frac{\text{Profit available for equity shareholders x Capitalization factor}}{\text{No. of equity shares}} = \frac{1,51,000 \text{ x } 14.286}{8,000}$$

=` 264.64 or say ` 270

Illustration: 10

Balance Sheet of Diamond Ltd.*as on 30.3.2015*

Liabilities	`	***Assets***	`
Share Capital:		Land and buildings	1,10,000
2,000 shares of ` 100	2,00,000	Plant and machinery	1,30,000
General reserve	40,000	Patents and trade marks	20,000
Profit and loss account	32,000	Stock	48,000
Sundry creditors	1,28,000	Debtors	88,000
Income-tax	60,000	Bank balance	52,000
		Preliminary expenses	12,000
	4,60,000		**4,60,000**

The expert valuer valued the land and buildings at ` 2,40,000; goodwill at ` 1,60,000; and plant and machinery at ` 1,20,000. Out of the total debtors, it is found that debtors of ` 8,000 are bad. The profits of the company have been as follows:

	`
2012-13	80,000
2013-14	90,000
2014-15	1,06,000

The company follows the practice of transferring 25% of profits to general reserve. Similar type of companies earn at 10% of the value of their shares. Ascertain the value of the company’s shares under: (*i*) intrinsic value method; (*ii*) yield value method; and (*iii*) fair value method. Ignore taxation.

Solution

VALUATION OF SHARES OF DIAMOND LTD.

(*i*) Intrinsic Value Method:	**`.**
Assets:	
Land & buildings	2,40,000
Goodwill	1,60,00
Plant & machinery	1,20,000
Patents and trade marks	20,000
Stock	48,000
Debtors *less* bad debts	80,000
Bank balance	52,000
	7,20,000
Less: Liabilities:	
Sundry creditors	1,28,000
Net assets	5,92,000

$$\text{Intrinsic value of shares (each share)} = \frac{\text{Net Assets}}{\text{No. of shares}} = \frac{`\ 5{,}92{,}000}{2{,}000} = `296$$

(*ii*)Yield Value Method:	`
Total profit of last three years	2,76,000
Less: Bad debts	8,000
	2,68,000
Average profit = 2,68,000 4-3	89,333
Add: Decrease in depreciation on plant & mach. (say @ 5% on ` 10,000)	1,500
	90,833
Less: Increase in depreciation on Land & Bldg. (say @ 10% on ` 1,30,000)	13,000
Average profit	77,833
Less: Transfer to reserve (@ 25% of ` 77,833)	19,458
Profit available for Dividend	58,375

$$\text{Rate of Dividend} = `.\ \frac{58{,}375}{2{,}00{,}000} \times 100 = 29.187\%$$

Yield Value of each share

$$= \frac{\text{Possible rate of dividend}}{\text{Normal rate of return}} = \text{Paid up value of share} = \frac{296.187}{10} = 100 = \text{Rs. } 291.87$$

(*iii*)Fair Value Method:

$$\text{Fair Value of Share} = \frac{\text{Instrinsic value + Yield value}}{2} = \frac{296 + 291.87}{2} = \text{Rs. } 293.93$$

Earning Capacity

Under this method of valuation of shares are made on the basis of the disposable profit of the company. The profit is found out be deducting reserves and taxes from the net profit of the company. The profits earned by the company are compared with the amount of capital employed in the business and rate of earning is found out in the following manner:

$$\frac{\text{Profit earned}}{\text{Capital employed}} \times 100 = \text{Rate of earning}$$

Illustration:11

Shri Das holds 5,000 Enquiry Shares in Hindustan Ltd., the nominal and paid up capital of which consists of:

i. 20,000 Enquiry Shares of ` 1 each.
ii. 10,000 5 per cent Preference Shares of `.1 each.

Note: The preference shares do not participate further in the profits.

It is ascertained:

a) The normal annual net profit of such a company is `.5,000; and
b) The normal return by way of dividend on the paid of Equity Share Capital for the type of business carried out by the company is 8 per cent.

Shri Das requires you to value his share-holding based upon the above figures

Solution:

	`
Annual Net Profit	5,000
Less: Preference share dividend @ 5% on Rs. 10,000	500
Profit available for equity dividend	4,500

Profits of ` 4,500 capitalised at 8% $= \frac{4,500 \times 100}{8} =$ ` 56,250

Earning capacity value of each equity share $= \frac{56,250}{20,000} =$ ` 2.81

Hence, the value of 5,000 share held by Sri das =5,000 x `2.81 = ` 14,050

ALTERNATIVELY:

Expect rate of return = (4,500 /20,000) x 100 =22.5%
Norma Return = 8%

Value of each equity share $= \frac{\text{Expected rate of return}}{\text{Normal return}} \times$ paid up value of share

= (22.5/8)x 1 = ` 2.81

Illustration: 12

The following is the balance sheet of B company Ltd.as on March 31, 2014

Liabilities	`	Assets	`
6,000 Equity share of `100 each	6,00,000	Cash	50,000
500 6% Debenture of ` 100 each	5,00,000	Cash at bank	80,000
General Reserve	70,000	Sundry Debtors	1,20,000
Profit and Loss account	20,000	Stock	1.00,000
Sundry creditors	30,000	Land and Building	4,10,000
Other Liabilities	10,000	Furniture	60,000
		Goodwill	70,000
		Plant and machinery	3,40,000
	12,30,000		12,30,000

All the assets were independently valued at `13,80,000.The company earned net profits for the last five years as follows: ` 80,000,` 84,000,` 92,000, 88,000 and ` 96,000. It was decided to set aside 15% of the profits towards General reserve. This proportion was considered reasonable in the industry in which the company was engaged and where a fair investment return may be taken at 10%.Find out the value of equity share of the company by Assets Valuation Method and Yield Valuation Method.

SOLUTION:

(a) Assets Valuation Method:

	`	`
Value of Total Assets		13,80,000
Less: Liabilities:		
Sundry Creditors	30,000	
Other Liabilities	10,000	40,000
		13,40,000

Net Assets:	13,40,000
Less: Debentures	5,00,000
	8,40,000
No. of Equity Shares	6,000

Value per share = 8,40,000/6000 = `. 140

(a) Yield valuation method:

Net profits for five years =` 80,000 + ` 84,000 + ` 92,000 + 88,000 +` 96,000

= ` 4,40,000

Average net profits for five years = 4,40,000/5	88,000
Average net profit	88,000
Less: 15% transferred to Reserve	13,200
	74,800
Capital Yielding at 10%	

74,800 x 10/6000 = 7,48,000/600 = `124.66

Value per equity share = ` 124.66

Self Test Question Theory

1. State the need for computation of value of the shares.
2. What are the factors that influence valuation of shares?
3. What are the methods employed for the valuation of shares?

Problems

1. Mr. Sharewallah holds 12,000 equity shares in Bharti Ltd., the nominal and paid up capital of which consists of :

i. 40,000 equity share of ` 1 each

ii. 10,000 8% preference share of ` 1 each.

Note: The preference shares do not participate further in profits.

It is ascertained

(a) The normal annual net profit of such a company is ` 12,000; and

(b) The normal return by way of dividend on this paid up value of equity share capital for the type of business carried out by the company is 15%.

Mr. Sharewallah requires you to value his share holding based upon the above figures.

2. The following is the summarized balance sheet of Victory Machines Ltd as on 31st March, 2014

Liabilities		`	Assets	`
Share capital			Freehold property	1,20,000
30,000 Equity shares of ` 10 each		3,00,000	Plant	50,000
			Stock	3,10,000
Reserves and Surplus:			Debtors	2,03,000
General	1,20,000		Bank	1,17,000
Capital	40,000		Cash	1,700
Profit and loss	1,20,000	2,80,000		
Current liabilities & Provisions:				
Creditors	93,700			
I.T. Payable	11,500			
Proposed Dividend	34,500			
Provision for taxation	82,000	2,21,000		
		8,01,700		8,01,700

Net profit (before taxation) for the past three years ending:

31st March, 2012 `. 1,38,000

31st March, 2013 `. 1,83,000

31st March, 2014 `. 1,97,000

Freehold property was valued early in 2014 at `. 1,60,000 Average yield in this type of business is 15% on capital employed.

You are required to find out the value of each equity share on the basis of above mentioned facts.

3. It is provided in the Articles of Association that at the death of a shareholder his shares will be purchased by the remaining shareholders at a price to be settled on the basis of the last balance sheet. It is further provided that goodwill shall be valued on the basis of three years purchase of the average annual profits for the last five years.

Liabilities	`	Assets	`
20,000 Equity shares of ` 10		Goodwill	2,00,000
each	2,00,000	Investment at cost	
General Reserves	2,00,000	(market value	3,00,000
Workmen's saving fund	2,00,000	`.2,50,000)	5,00,000
Employees provident fund	1,00,000	Stock at cost	4,00,000
Creditors	6,00,000	Debtors	70,000
Profit and loss account	1,70,000	Bank balances	
	14,70,000		14,70,000

The profits for the last five years were `. 15,000, Rs. 20,000, `. 25,000, `. 30,000 and ` 35,000. You are required to calculate the price to the paid for each share.

4. The following is the Balance sheet of A Ltd. as onMarch 31, 2014:

Liabilities	`	Assets	`
Share Capital:		Land and Building	30,000
10,000 shares of ` 5 each	50,000	Plant and Machinery	30,000
General Reserves	15,000	Trade Marks	5,000
Taxation Reserves	10,000	Stock	12,000
Workmen's saving account	7,500	Debtors	20,000
Creditors	24,500	Cash at Bank	15,000
Profit and loss account	8,000	Preliminary Expenses	3,000
	1,15,000		1,15,000

The land and Building have been valued at `. 65,000 and the Plant and machinery is worth `. 25,000. Debtors to the extent of ` 2,000 are to be considered as bad. The profits of the company for the last three years have been follows:

2011-12 ` 22,000; 2012-13 ` 23,000; and 2013-14 ` 26,000.

It is the company practice to transfer 25% of profits to Reserves. Ignoring taxation, find out the value of the share. Similar companies give a yield of 10% on the market value of their shares. Goodwill may be taken to be of the value of `40,000.

UNIT-V

Final Statements of Accounts of Insurance Companies

Learning Objectives

After reading this lesson you should be able to

- Know the important provisions relating to final accounts of insurance companies
- Familiar with the prescribed formats of the Revenue account, Profit and Loss Account and Balance Sheet of a insurance company
- Understand the mode of disclosure of accounting policies adopted by a insurance company and accounting treatment for specific adjustment in final accounts
- Prepare final accounts of both life and general insurance companies.

Introduction

In an Insurance Contract one party agrees for a consideration called premium to indemnify the other against a possible loss or to pay a stated sum of money on the happening of a particular event. This agreement or contract when put in writing is known as **policy**. The person whose risk is covered is called **insured or assured** and the company or corporation which insures is known as **insurer, assurer or underwriter**. The consideration in return for which the insurer agrees to make good the loss is known as **premium**.

Types of Insurance

From accounting point of view, the insurance may be divided into two as follows:

1. Life Insurance

Section 2 of Indian Insurance Act 1938 defines life insurance as “life insurance business is the business of effecting contracts upon human life”.It is a long term contract in which the assured must pay the premium at stated intervals and the insurer guarantee to pay a certain sum of money to the assured on the happening of the event which is certain (either death or expiry of the fixed period).

2. General Insurance

All insurance other than life insurance is general insurance. Under this type of insurance,the insurer undertakes to indemnify the loss suffered by the insured on happening of a certain event in consideration for a fixed premium. Usually all these are short term agreements for a year. Fire insurance, marine insurance, accident insurance, burglary insurance, third party insurance etc. are the examples for general insurance.

FINANCIAL STATEMENTS OF INSURANCE COMPANIES

Insurance Regulatory and Development Authority (IRDA) has issued the regulations regarding the preparation of financial statements.

Final Accounts of Life Insurance Companies Application of Accounting Standards

Every balance sheet, receipts and payment account [Cash Flow Statement] and profit & loss A/c [shareholder's A/c] of the insurer shall be in confirmiry with the accounting standards (AS) issued by the ICAI, to the extent applicable to the insurer carrying on general insurance business, except that:

(i) AS 3 – Cash Flow Statement shall be prepared only under the direct method.

(ii) AS 13 – accounting for investment shall not be applicable.

(iii) AS 17 – segment reporting shall apply irrespective of whether the securities of the insurer are traded publically.

tes to Forms *A-RA* and *A-PL*

(a) Premium income received from business concluded in and outside India shall be separately disclosed.

(b) Re-insurance premiums whether on business cede or accepted are to be brought into account goes (i.e., before deducting commission) under the head re-insurance premiums.

(c) Claims insured shall comprise claims paid, specific claims settlement costs wherever applicable and change in the outstanding provision for claims at the year-ended.

(d) Items of expenses and income in excess of one per cent of the total premium (less re-insurance) or Rs. 5,00,000 whichever is higher, shall be shown as a separate line item.

(e) Fees and expenses connected with claims shall be included in claims.

(f) Under the sub-head "Others" shall be included items like foreign exchange gains or losses and other items.

(g) Interest, dividends and rentals receivable in connection with an investment should be stated as gross amount, the amount of income tax deducted at source being included under "advance taxes and taxes deducted at source".

(h) Income from rent shall include only the realised rent. It shall not include any national rent.

The final accounts of a life insurance company consist of (a) Revenue Account, (b) Profit and Loss A/c and (c) Balance Sheet. The formats of this given by IRDA are as follows:

FORM A-RA

Revenue Account for the year Ended 31st March, 20…..

Particulars	*Schedule*	*Current Year (`'000)*	*Previous Year (`'000)*
Premiums Earned (Net) a. Premium b. Reinsurance ceded c. Reinsurance accepted Income from investments a. Interest, Dividend & Rent – Gross b. Profit on sale / Redemption of investments c. (Loss on sale / redemption of investments) d. Transfer / Gain on revaluation / change in fair value Other income (to be specified)	**1**		
TOTAL (A)			
Commission Operating Expenses related to insurance business Provision for doubtful debts Bad debts written off Provision for tax Provisions (other than taxation) a. For distribution in the value of investments (net) b. Others (to be specified)	**2** **3** **4**		
TOTAL (B)			
Benefits paid (net) Interim bonus paid Change in the valuation of liability in respect of life policies a. Gross b. Amount ceded in reinsurance Fire/ Marine/Miscellaneous business			
TOTAL (C)			
Surplus (Deficit) *(D) = (A) - (B) - (C)* Appropriations Transfer to Shareholders' Account Transfer to Other Reserves (to be specified) Balance being funds for future Appropriations			
TOTAL (D)			

FORM A-PL

Profit & Loss A/c for the year Ended 31st March, 20…..

Particulars	*Schedule*	*Current Year (`.’000)*	*Previous Year (`.’000)*
Amounts transferred from/to the policyholders account (Technical Account) Income from investments a. Interest, Dividend & Rent – Gross b. Profit on sale / Redemption of investments c. (Loss on sale / redemption of investments) Other income (to be specified)			
TOTAL (A)			
Expenses other than those directly related to the insurance business Bad debts written off Provisions (other than taxation) a) For diminution in the value of investments (Net) b) Provision for doubtful debts c) Others (to be specified)			
TOTAL (B)			
Profit (loss) before tax Provision for taxation Profit (loss) after tax Appropriations a) Balance at the beginning of the year b) Interim dividends paid during the year c) Proposed final dividend d) Dividend Distribution Tax e) Transfer to Reserves or other accounts (to be specified) Profit earned .... to the balance sheet			

FORM A-BS

Balance Sheet as at 31st March, 20….

Particulars	*Schedule*	*Current Year (`.’000)*	*Previous Year (`.’000)*
SOURCES OF FUNDS			
Shareholder’s funds	**5**		
Share capital	**6**		
Reserves And Surplus			
Credit/[Debit]Fair Value Change Account	**7**		
Sub-Total			
Borrowings			
Policyholders’ Funds:			
Credit/[Debit]Fair Value Change Account			
Policy Liabilities			

Insurance Reserves Provision for Linked Liabilities			

Sub-Total Funds for future appropriations			
TOTAL			
APPLICATION OF FUNDS Investments Shareholders' Policyholders' Assets held to cover linked liabilities Loans Fixed Assets Current Assets Cash and Bank Balances Advances and Other Assets **Sub-Total (A)** Current Liabilities Provisions **Sub-Total (B)** Net Current Assets *(C)=(A)-(B)* Miscellaneous Expenditure (to the extent not Written off or adjusted) Debit Balance in Profit and Loss Account (Shareholders' Account)	**8** **9** **10** **11** **12** **13** **14** **15**		
TOTAL			

CONTIGENT LIABILITIES

Particulars	*Current Year (`.'000)*	*Previous Year (`.'000)*
I. Partly paid-up investments II. Claims, other than against policies, not acknowledged as debts by the company III. Underwriting commitments outstanding (in respect of shares and securities) IV. Guarantees given by or on behalf of the company V. Statutory demands/liabilities in dispute, not provided for VI. Reinsurance obligations to the extent not provided for in accounts Others (to be specified)		
TOTAL		

Practical Problems in Life Insurance Business

Illustration 1

Best Life Insurance Co. Ltd. had a paid up capital of `10,00,000 divided into 1,00,000 shares of `10 each. Its net liability on all contracts in force as on 31st March, 2014 was `96,00,000 and on 31st March 2013 this liability was `84,00,000. The company has paid an interim bonus of `2,60,000 and 20% of the surplus is to be allocated to shareholders, 20% to reserves and balance carried forward. The following figures are extracted from the books of the company for the year ended 31st March, 2014.

Particulars	`	Particulars	`
Premium less re – insurance premium	57,20,000	Commission	2,20,000
		Surrenders	3,20,000
Interest, dividend and rent Fees	28,00,000	Surplus on revaluation of reversions	20,000
Fees	16,000		
Income – tax	4,40,000	Re-insurance irrecoverable	16,000
Management expenses	7,00,000	Claims less re-insurance claims	34,00,000
Annuities	50,000	Consideration for annuities granted	1,60,000

Prepare Revenue Account

Solution

Best Life Insurance CO. Ltd.

Revenue account for the year ended 31st March, 2014

Particulars		Schedule	(`000)
Premiums earned – net		1	57,20
Income from investments			
Interest, Dividends and Rent – Gross			28,00
Surplus on Revaluation of Reversions			20
Other income:			
Consideration from Annuities Granted			1,60
Fees			16
Total (A)			87,16
Commission		2	2,20
Operating Expenses related to insurance Business		3	7,00
Re-insurance irrecoverable			16
Income – tax			4,40
Total (B)			13,76
Benefits Paid (Net)		4	37,70
Interim Bonuses Paid			2,60
Change in valuation of liability in respect of life policies:			
Net liability on all Contracts on 31.3.2014	96,00		

Less: Net Liability on all Contracts on 31.3.2013	84,00		12,00
Total (C)			52,30
Surplus/ (Deficit) (D) = (A) – (B) – (C)			21,10
Appropriations			
Transfer to Shareholder's Account (20% of Rs. 21,10,000)			4,22
Transfer to Reserves (20% of Rs. 21,10,000)			4,22
Balance being Funds for Future Appropriations			12,66
Total (D)			21,10

Schedule 1 – Premium Earned (Net)

Particulars	**(` '000)**
Premium less Reinsurance Premium	57,20

Schedule 2 – Commission Expenses

Particulars	**(`'000)**
Commission Paid	2,20

Schedule 3 – Operating Expenses Relating to Insurance Business

Particulars	**(` '000)**
Management Expenses	7,00

Schedule 4 – Benefits Paid

Particulars	**(`'000)**
Claims less Reinsurance	34,00
Annuities	50
Surrenders	3,20
	37,70

Illustration 2

The under mentioned balances form part of the Trial Balance of the All People's Assurance Co. Ltd., as on 31st March, 2013 :

Amount of Life Assurance Fund at the beginning of the year, `14,70,562 thousand; claims by death `76,980 thousand; claims by maturity, ` 56,420 thousand; premiums, ` 2,10,572 thousand: expenses of management, `19,890 thousand; commission, `26,541 thousand; consideration for annuities granted `10,712 thousand; interests, dividends and rents, `52,461 thousand; income tax paid on profits `3,060 thousand; surrenders, `21,860 thousand; annuities, `29,420 thousand; bonus paid in cash, `9,450 thousand; bonus paid in reduction of premiums, `2,500 thousand; preliminary expenses balance, `600 thousand; claims admitted but not paid at the end of year, `10,034 thousand; annuities due but not paid, ` 2,380 thousand; capital paid up, `14,00,000 thousand; Government securities, `24,90,890 thousand; Sundry Fixed Assets, `4,19,110 thousand.

Prepare Revenue Account and the Balance Sheet after taking into account the following:

(a) Claims covered under reinsurance, ` 10,000 thousand

(b) Further claims intimated, ` 8,000 thousand by death;

(c) Further bonus utilized in reduction of premium, `1,500 thousand

(d) Interest Accrued, `15,400 thousand;

(e) Premiums Outstanding, `7,400 thousand.

Solution:

All People'sAssurance Co. Ltd.

Revenue Account for the year ended 31st March, 2013

Particulars	***Schedule***	***`'000***
Premiums earned - net	1	2,19,472
Income from Investments		67,861
Other Income :		
Consideration for Annuities granted		10,712
Total (A)		**2,98,045**
Commission	2	26,541
Operating Expenses related to Insurance Business	3	19,890
Provision for Tax		3,060
Total (B)		**49,491**
Benefits Paid (Net)	4	1,96,130
Total (C)		1,96,130
Surplus (D) = (A) - (B) - (C)		52,424
Balance being Funds for Future Appropriations		52,424
Total (D)		**52,424**

All People'sAssurance Co. Ltd.
Balance Sheet as at 31st March, 2003

Source of Funds	***Schedule***	***`. '000***
Share Capital	5	13,99,400
Policyholders' Funds		14,70,562
Life Assurance Fund		28,69,962
Funds for Future Appropriations		52,424
Total		**29,22,386**
Application of Funds		
Investments	8	24,90,890
Fixed Assets	10	4,19,110
Current Assets:		
Advances and Other Assets	12	32,800
Sub Total (A)		32,800
Current Liabilities	13	20,414
Sub Total (B)		20,414
Net Current Assets (C) = (A) - (B)		12,386
Total		**29,22,386**

SCHEDULE-1

Premium	
Premiums earned-net	2,19,472

SCHEDULE-2

Commission Expenses	26,541

SCHEDULE- 3

Operating Expenses Related to Insurance Business	19,890

SCHEDULE – 4

Benefits Paid (Net)

1. Insurance Claims	
(a) Claims by Death	84,980
(b) Claims by Maturity	56,420
(c) Annuities	29,420
(d) Surrenders	21,860
Bonus in cash	9,450

Bonus in reduction of Premiums	
2. (Amount ceded in reinsurance)	
(a) Claims by Death	10,0000
Total	**1,96,130**
SCHEDULE- 5	
Share Capital	20,00,000
Called up and paid-up Capital	600
Less: Preliminary Expenses	**19,99,400**
Total	
SCHEDULE - 8	
Investments	
Government Securities	24,90,890
Total	**24,90,890**
SCHEDULE-10	
Fixed Assets	4,19,110
Total	**4,19,110**
SCHEDULE-12	
Advances and Other Assets	
Other Assets	
Interest accrued on investments	15,400
Outstanding premiums	7,400
Due from Reinsurers	10,000
Total	**32,800**
SCHEDULE-13	
Current Liabilities	
Claims Outstanding	20,414
Total	**20,414**

Working Notes :

(i) Premiums received	2,10,572
Add Outstanding	7,400
Covered by bonus utilized for reduction of premium	1,500
Premiums earned (net)	**2,19,472**
(ii) Interest dividends and rents	52,461
Add: Interest accrued	15,400
Income from Investments	**67,861**

llustration 3

Getwell Life Assurance Co. Ltd. got its valuation made once in every three years. The life assurance fund on 31st March, 2015 amounted to `83,84,000 before providing for `.64,000 for the shareholder's dividend for the year 2014-15. Its actuarial valuation on 31st March, 2015 disclosed net liability of `.80,80,000 under the triennium ending 31st March, 2015. Prepare statement showing the amount now available as bonus to policyholders.

Solution:

Valuation Balance Sheet of Getwell Life Assurance Co. Ltd as on March 31,2015

	`		`
To Net Liability as per actuary's Valuation To Surplus	80,80,000 3,04,000	By Life Assurance Fund as per Balance Sheet	83,84,000
	83,84,000		83,84,000

	`
Profits made: Surplus as per Valuation Balance Sheet	3,04,000
Add: Interim bonus paid to policy holders	80,000
	3,84,000
Less: Dividend for 2014-15 due to shareholders	64000
Profit for 3years ending March 31,2015	3,20,000
Policyholders will get 95% of `.3,20,000 or	3,04,000
Less: amount already paid as interim bonus	80,000
Amount now due to the policyholders	2,24,000

Illustration 4

The Life fund of a Life Insurance Company on 31st March 2013 showed a balance of `54,00,000. However, the following items were not taken into account while preparing the Revenue Account for 2012-13.

	`
(i) Interest and dividends accrued on investments	20,000
(ii) Income tax deducted at source on the above	6,000
(iii) Reinsurance claims recoverable	7,000
(iv) Commission due on reinsurance premium paid	10,000

(v)Bonus in reduction of premiums 3,000

Solution:

Statement Showing True Life Fund of Life Insurance Co. as on 31st March 2013

Particulars	`	`
Life Assurance fund given		54,00,000
Add: Interest & Dividend accrued on invest	20,000	
Less:Income tax Thereon	6,000	

	14,000	
Reinsurance claims recoverable	7,000	
Commission due on reinsurance premium Paid	10,000	
Premium in reduction of bonus	3,000	
	--------	34,000

		54,34,000
Less: Bonus in reduction of premium		3,000

True Life Assurance Fund		54,31,000

Note: Bonus in reduction of premium reduces premiums and also bonus. So it has to be added and also substrates from the fund.

Illustration 5

The following balance appeared in the books of the Happy Mutual Life Assurance Society Ltd. As on 31st March, 2012:

Dr. Particulars	**`in Lakhs**	**Cr. Particulars**	**`in Lakhs**
Claims less re-insurance paid during the year:		Life Assurance Fund at the beginning of the year	50,000
By Death	2,200	Premiums less re-assurances	15,000
By Maturity	1,500		

Annuities	6	Claims less re-assurances outstanding at the beginning of the year:	
Fumiture and Office Equipment at cost (including `40 Lakhs bought during the year)	250	By Death	900
		By Maturity	600
Printing and stationery	77	Credit balances pending adjustment	60

Cash with Bank in Current Account	1,350	Consideration for annuities granted	2
Cash and Stamps in Hand	30	Interests, dividends and Rents	1,800
Surrenders less re-assurances	40	Registration and other fees	2
Commission	250	Sundry deposits	100
Expenses of Management	3,100	Taxation provision	300
Sundry deposits with Electricity Companies, etc.	1	Premium deposits	1,500
Advance Payment of Income-tax	50	Sundry creditors	350
Sundry Debtors	50	Contingency reserve	150
Agents Balances	100	Furniture and office equipment depreciation account	40
Income-tax	450	Building depreciation account	300
Income tax on interest, dividends and rents	500		
Loans and Mortgages	150		
Loans on Policies	3,250		
Investments (` 250 Lakhs deposited with the RBI)	52,000		
House Property at cost (Including ` 85 Lakhs deposited with the RBI)	5,400		
	70,754		70,754

From the foregoing balances and the following information, prepare Balance Sheet of the Happy Mutual Life Assurance Society Ltd. As on 31st March, 2012 and its

Revenue Account for the year ended on that date:

(1) Claims less re-assurances outstanding at the end of the year By Death: `. 600 lakhs; By Maturity: ` 400 lakhs.

(2) Expenses outstanding `60 lakhs and prepaid `15 lakhs.

(3) Provide ` 45 lakhs for depreciation on building; `15 lakhs for depreciation on furniture and office equipment and `110 laksh for taxation.

(4) Premiums outstanding Rs . 2,028 lakhs; Commission thereon `65 lakhs.

(5) Interest, dividends and rents outstanding (net) `30 lakhs and interest and rest accrued (net) ` 250 lakhs.

Solution

Happy Mutual Life Assurance Society Ltd.

Balance Sheet as at 31st March, 2012

Particulars	Schedule		` In Lakhs
Sources of funds			
Shareholders Funds			
Share Capital	5	-	
Reserves and Surplus	6	61,759	
Borrowings	7	1,250	63,009
Application of funds			
Investments			
Shareholders	8	56,805	
Loans	9	3,400	
Fixed Assets	10	195	60,400
Current Assets			
Cash and Bank Balances	11	1,380	
Advances and Other Assets	12	2,874	
Sub – total (A)		4,254	
Current Liabilities	13	1,535	
Provisions	14	110	
Sub – total (B)		1,645	
Net Current Assets (C) = (A-B)			2,609
Total			63,009

Happy Mutual Life Assurance Society Ltd.

Revenue Account for the year ended 31st March, 2002

Particulars	Schedule	`In Lakhs
Premiums earned – net	1	17,028
Income from investments		
Interest, Dividends and Rent – Gross		2,180
Other Income		
Annuities Granted		2

Registration and Other Fees		2
Total (A)		19,212
Commission	2	315
Operating Expenses related to Insurance Business	3	3,282
Provision for tax		760
Total (B)		4,357
Benefits Paid (Net)	4	3,246
Total (C)		3,246
Surplus /(Deficit) (D) = (A) – (B) – (C)		11,609

1. Calculations of Provision for Taxation:

Particulars	` in lakhs
Income Tax paid	450
Income tax on interest, dividend and rent	500
Provision for taxation to be made	110
	1060
Less : Existing taxation provision	300
	760

Schedule 1: Premiums

Particulars	` in lakhs
Premium	15,000
Add: Outstanding	2,028
	17,028

Schedule 2: Premiums

Particulars	`in lakhs
Commission Paid	250
Add: Commission on re-insurance accepted	65
	315

Schedule 3: Operating Expenses

Particulars		` in lakhs
Expenses of Management Paid	3,100	
Add: Unpaid	60	
	3,160	
Less: Prepaid	15	3,145
Printing and Stationery		77
Depreciation on:		
Building	45	
Furniture	15	60
		3,282

Schedule 4: Benefits Paid

Particulars		` in lakhs
Insurance Claims		
Claims by Death -		
Paid	2,200	
Add: Outstanding at the end	600	

	2,800	
Less: Outstanding at the beginning	900	1,900
Claims by Maturity		
Paid	1,500	
Add: Outstanding at the end	400	
	1,900	
Less: Outstanding at the beginning	600	1,300
Other Benefits		
Annuities		6
Surrender less re-insurance		40
		3,246

Schedule 6: Reserves and Surplus

Particulars	` in lakhs
Contingency Reserve	150
Life assurance Fund	61,609
	61,759

Schedule 7: Borrowings

Particulars	` in lakhs
Premium Deposits	1,150
Sundry Deposits	100
	1,250

Schedule 8: Investments

Particulars		` in lakhs
Sundry Other Investments		51,750
Investments in House Property	5,315	65
Add: Addition	85	
	5400	
Less: Depreciation	345	5,055
		56,805

Schedule 9: Loans

Particulars	`in lakhs
On Mortgages	150
On Policies	3,250
	3,400

Schedule 10: Fixed Assets

Particulars	(`'100)
Furniture at Cost less Depreciation	195

Schedule 11: Cash and Bank Balances

Particulars	` in lakhs
Cash in Hand including Stamp	30
Cash with Banks on Current Account	1,350
	1,380

Schedule 12: Advances and Other Assets

Particulars	`in lakhs

Prepaid Expenses	15
Interest, Dividends and Rent Outstanding	30
Interest, Dividends and Rent Accruing	350
Advance Payment on Income Tax	50
Agent's balances	100
Outstanding Premium	2,028
Deposit with RBI	250
Deposit with Electricity Companies	1
Sundry Debtors	50
	2,874

Schedule 13: Current Liabilities

Particulars	`in lakhs
Sundry Creditors	350
Claims Outstanding	1,000
Credit Balances pending Adjustments	60
Outstanding Expenses	60
Commission Due but not yet Paid	65
	1,535

Schedule 14: Previous

Particulars	` in lakhs
Provision for Tax	110

Final Accounts of General Insurance Companies

FORM B-RA

Revenue Account for the year Ended 31st March, 20…..

Particulars	*Schedule*	*Current Year (`.'000)*	*Previous Year (`.'000)*
1. Premiums Earned (Net) 2. Profit/Loss on sale / redemption investments 3. Others (to be specified) 4. Interest, Dividend & Rent - Gross	**1**		
TOTAL (A)			
1. Claims Incurred (Net) 2. Commission 3. Operating Expenses related to insurance business	**2** **3** **4**		
TOTAL (B)			
Operating Profit/ (Loss) from Fire/ Marine/Miscellaneous business *(C)=(A) -(B)*			
APPROPRIATIONS Transfer to Shareholders' Account Transfer to Catastrophe Reserve Transfer to Other Reserves (to be specified)			
TOTAL (C)			

FORM B-PL

Profit & Loss A/c for the year Ended 31st March, 20…..

Particulars	Schedule	Current Year (`.'000)	Previous Year (`.'000)
1. Operating Profit/ (Loss) a) Fire Insurance b) Miscellaneous Insurance **2. Income from investments** a) Interest, dividends & rent – Gross b) Profit on sale/redemption of investments *Less*: Loss on sale of investments **Other Income** (to be specified)			
TOTAL (A)			
3. Provisions (other than taxation) d) For diminution in the value of investments e) For Doubtful Debts f) Others (to be specified) **4. OTHER EXPENSES** a) Expenses other than those directly related to the insurance business b) Bad debts written off c) Others (to be specified)			
TOTAL (B)			
Profit before tax Provision for taxation 5. **APPROPRIATIONS** f) Interim dividends paid during the year g) Proposed final dividend h) Dividend Distribution Tax i) Transfer to Reserves or other accounts (to be specified) Balance of Profit/Loss brought forward from last year Balance carried forward to the Balance Sheet			
APPROPRIATIONS Transfer to Shareholders' Account Transfer to Catastrophe Reserve Transfer to Other Reserves (to be specified)			

FORM B-BS

Balance Sheet as at 31st March, 20….

Particulars	Schedule	Current Year (`.'000)	Previous Year (`.'000)

SOURCES OF FUNDS SHARE CAPITAL RESERVES AND SURPLUS FAIR VALUE CHANGE ACCOUNT BORROWINGS	**5** **6** **7**		
TOTAL (A)			
APPLICATION OF FUNDS INVESTMENTS LOANS FIXED ASSETS CURRENT ASSETS Cash and Bank Balances Advances and Other Assets	**8** **9** **10** **11** **12**		
Sub-Total (A)			
Current Liabilities	**13**		
Provisions	**14**		
Sub-Total (B)			
NET CURRENT ASSETS (C)=(A)-(B) MISCELLANEOUS EXPENDITURE (to the extent not written off or adjusted) DEBIT BALANCE IN PROFIT AND LOSS ACCOUNT	**15**		
TOTAL			
VII. Partly paid-up investments VIII. Claims, other than against policies, not acknowledged as debts by the company IX. Underwriting commitments outstanding (in respect of shares and securities) X. Guarantees given by or on behalf of the company XI. Statutory demands/liabilities in dispute, not provided for XII. Reinsurance obligations to the extent not provided for in accounts XIII. Others (to be specified)			
TOTAL			

Practical Problems in General Insurance Business

Illustration 6

Zaldi Pay Insurance Co. Ltd. Has furnished the following information for preparation of Revenue Account for fire insurance business for the year ended 31st March, 2015.

	`
Claims admitted but not paid	42,376
Commission paid	50,000
Commission on reinsurance received	12,000
Share transfer fees	12,000
Expenses of Management	5,000
Bad Debts	78,000
Claims Paid	2,500
Profit and Loss Account Appropriation	15,000
Premiums Received (less Reinsurance)	10,000
Reserve for Unexpired Risks as on 1.4.2014	5,52,000
Claims Outstanding as on 1.4.2014	2,30,000
Dividend on Share Capital	27,000

The following further information has also to be considered:

(i) Premiums outstanding at the end of the year is `40,000

(ii) It is the policy of the company of maintain 50% of premium towards reserve for unexpired risks.

Solution

Zaldi Pay Insuracne Co. Ltd.

Fire Revenue Account for the Year ended 31st March, 2015

Particulars		**Schedule**	`
Premiums earned – net		1	2,96,000
	Total (A)		2,96,000
1. Claims Incurred (Net)		2	30,376
2. Commission		3	38,000
3. Operating Expenses related to Insurance Business			78,000
	Total (B)		1,46,376
Operating Profit/ (Loss) from Fire/ Marine/ Miscellaneous Business C = (A-B)			1,49,624

Schedule 1 – Premium Earned (Net)

Particulars	`	`
Premium received (less re-insurance)	5,52,000	
Add: Premium Outstanding	40,000	5,92,000
Adjustment for Changes in Reserve for unexpired risk:		
Opening balance of reserve	40,000	
Less: Closing balance of reserve (Note 1)	2,96,000	(2,56,000)
Total Premium Earned (Net)		2,96,000

Schedule 2 – Claims Incurred (Net)

Particulars	``	
Claims Paid during the Year	15,000	
Add: Claims outstanding at the end of year	42,376	
	57,376	
Less: Outstanding Claims at the beginning of the year	27,000	30,376

Schedule 3 – Commission

Particulars	`	`
Commission Paid:		
Direct	50,000	
Add: Re-insurance accepted	-	
	50,000	
Less: Commission on re-insurance ceded	12,000	38,000

Working Note: (1) Reserve for unexpired risk = 50% of `5,92,000 = ` 2,96, 000.

Tutorial Note: Share transfer fees and bad debts are shown in the Profit and Loss Account.

Illustration 7

From the following figures taken from the books of New Asia Insurance Co. Ltd., doing the underwriting business, prepare the set of Final Accounts for the year 2014 -15.

Particulars	`	Particulars	`
Fire Fund (as on	9,30,000	Commission on Direct	
1.4.2014)	4,50,000	Business	2,99,777
General Reserve	36,00,000	Commission on Reinsurance	
Investments	27,01,533	Accepted	60,038
Premium	6,02,815	Outstanding Premium	22,300
Claims Paid		Claims intimated but not	
Share Capital – Divided	9,00,000	paid (1.4.2014)	60,000
into Equity Share of `		Expenses on Management	4,31,947
100 each	3,30,000	Audit Fees	36,000
Additional Reserve		Rates and Taxes	5,804
	75,000	Rents	67,500
Profit and Loss A/c (Cr.)	1,12,525	Income from investments	1,53,000
Re-insurance Premium		Sundry Creditors	22,500
Claim Recovered from	21,119	Agents balances (Dr.)	20,000
Re-insurers	48,016	Cash on Hand and Bank	1,82,462
Commission on Re-		Balances	
insurance Ceded	2,50,000		
Advance income – tax			
paid			

The following further information may also be noted:

(a) Expenses of management include survey fees and legal expenses of ` 36,000 and `20,000 relating to claims;

(b) Claims intimated but not paid on 31st March, 2015 `1,04,000.

(c) Income – Tax to be provided at 35%.

(d) Transfer of ` 2,00,000 to be made from current profits to General Reserve.

Solution

New Asia Insurance Co. Ltd.,

Fire Revenue Account for the year ended 31st March, 2015

Particulars		**Schedule**	`
Premiums earned – net		1	22,24,504
	Total (A)		22,24,504
1. Claims Incurred (Net)		2	6,81,696
2. Commission		3	3,11,799
3. Operating Expenses related to Insurance Business			4,85,251
	Total (B)		14,78,746
Operating Profit/ (Loss) from Fire/ Marine/ Miscellaneous Business C= (A-B)			7,45,758

Profit and Loss Account for the year ended 31st March, 2015

Particulars	Schedule	`
1. Operating Profit/(Loss)		
(a) Fire Insurance		7,45,758
(b) Marine Insurance		-
(c) Miscellaneous Insurance		1,53,000
2. Income from investments		1,53,000
3. Other Income (to be specified)		-
Total (A)		8,98,758
4. Previous (other than taxation)		-
5. Other Expenses		-
Total (B)		-
Profit Before Tax		8,98,758
Provision for Taxation		3,14,565
Appropriations		
Transfer to general reserve		2,00,000
Balance of profit/ loss brought forward from last year		75,000
Balance carried forward to Balance Sheet		4,59,193

New Asia Insurance Co. Ltd.
Balance Sheet as at 31st March, 2015

Particulars	**Schedule**	`
Sources of Funds		
Share Capital	5	9,00,000
Reserves and Surplus	6	11,09,193
Sub total		20,19,193
Application of Funds		
Investments		36,00
Loans	9	-
Fixed Assets	10	-
Current Assets		
Cash and Bank Balances	11	1,82,462
Advances and Other Assets	12	42,300

Sub – total (A)		2,24,762
Current Liabilities Provisions	13 14	1,26,500 16,89,069
Sub – total (B)		18,15,549
Net current Assets (C) = (A-B) Miscellaneous Expenditure (to the extent not written off or adjusted) Debit Balance in Profit and Loss Account (Shareholder's Account)	 15	(15,90,807) - -
Total		20,19,193

Schedule 1 – Premium Earned (Net)

Particulars	`	`
Premium	27,01,533	
Less: Re-insurance	1,25,525	25,89,008
Adjustment for Changes in Reserve for unexpired risk:		
Opening balance of reserve (`9,30,000 + 3,30,000)	12,60,000	
Less: Closing balance of reserve (`12,94,504 + 3,30,000)	16,24,504	(3,64,504)
Total Premium Earned (Net)		22,24,504

Schedule 2 – Claims Incurred (Net)

Particulars	`	`
Claims Paid during the year		
Direct	6,02,815	
Add: Survey fees	36,000	
Legal Expenses	20,000	6,58,815
Less: Received from re-insurance		21,119
		6,37,696
Add: Claims outstanding at the end of the year		1,04,000
		7,41,696
Less: Outstanding Claims at the beginning of the year		60,000
		6,81,696

Schedule 3 – Commission

Particulars	`	`
Commission Paid		
Direct	2,99,777	
Add: Re-insurance accepted	60,038	
	3,59,815	
Less: Commission on re-insurance ceded	48,016	3,11,799

Schedule 4 – Operating Expenses Related to Insurance Business

Particulars	`	`
Expenses on Management	4,31,947	
Rates and Taxes	5,804	
Rent	67,500	

Audit Fees	36,000	5,41,251

Less: Survey fees relating to claims Legal expenses relating to claims	36,000 20,000	56,000
		4,85,251

Schedule 5 – Share Capital

Particulars	`	`
9,000 Equity Shares of `100 each fully paid-up		9,00,000

Schedule 6 – Reserves and Surplus

Particulars	`	`
General Reserve: Opening balance Add: Addition during the year Balance of Profit and Loss Account	 4,50,000 2,00,000	 6,50,000 4,59,193
		11,09,193

Schedule 12 – Advances and Other Assets

Particulars	`	`.
Premium Outstanding Agent's Balance		22,300 20,000
		42,230

Schedule 13 – Current Liabilities

Particulars	`	`
Sundry Creditors Claims intimated but not paid		22,500 1,04,000
		1,26,500

Schedule 14 – Provision

Particulars	`	`.
Reserve for Unexpired Risk Provision for Taxation Less: Payment of Advance Tax	 3,14,565 2,50,000	16,24,504 64,565
		16,89,069

Working Notes;

(1) Reserve for expired risk = 50% of ` 25,89,008 = ` 12,94,504.
Assuming that the additional reserve will be maintained at the same level, the total closing balance of reserve for unexpired risk will be: ` 12,94,508 + `3,30,000 = ` 16,24, 504.

(2) Provision for Taxation to be created @ 35%. The amount of provision for income tax = 35% of `8,98,758 – `3,14, 565.

(3) No adjustment is required in Premium Account in respect of outstanding premium because it has already been done and that is why Outstanding Premium Account is appeared in the Trial Balance.

Self Test Questions Theory

1. Explain the method followed for arriving at rift in the life inusurance business.

2. Explain what do you understand by Life Fund. Where does it appear in the final Accounts?
3. How is profit or loss determined in Fire insurance Business?
4. What important points should be kept in mind in preparing the annual accounts of general Insurance companies?
5. Point out the main features of Accounts of General Insurance Companies. What statutory boos are required to be maintained by a general Insurance Company under the Insurance Act.
6. Explain how the profit or loss from general insurance business is ascertained and prepare a firm Revenue Account with imaginary figures.
7. Explain in brief disclosure forming part of financial statements.

Problems

1. The New India assurance company Ltd. had paid up capital of ` 2,50,000 divided into 25,000 shares of `10 each. Its net liability on all contracts in force on 31st March, 2014 was `22,50,000. From the following figures extracted from its books for the year ended 31st March, 2014, prepare Revenue Account and a Valuation Balance Sheet. The company had paid an interim bonus of `1,03,806 and 25% of the surplus is to allocated to shareholders and 70% to the policyholders.

	`		`
Interest, dividend and rents	7,50,000	Life fund	24,50,000
Premium	13,80,000	Fines and fees	720
Surplus on revaluation of reversions	4,800	Bonus in cash	1,58,400
Reassurance recoverable	1,250	Income-tax	1,16,500
Claims	8,90,000	Management expenses	1,75,000
Consider for annuities granted	45,000	Bonus in reduction of premium	1,976
Surrenders	85,200	Commission	54,000

2. The life insurance fund of an insurance company was on 31.03.2014 `60 lakhs before providing dividend of ` 20,000 for the year 2013-2014. While ascertaining the above fund figure, the following items were omitted:

1. Interest received on investments ` 63,000 after deduction for tax at source 10%.
2. Bonus utilized for reduction of premium ` 14,000.
3. Death claim intimated, but not yet admitted ` 36,000.
4. Death claim covered under re-insurance ` 12,000.
5. Consideration for annuities granted ` 9,000.

Interim bonus for the valuation period paid was ` 80,000.

Net liabilities as per valuation were ` 50 lakhs. It is now proposed to carry forward ` 2,70,000. The company declared a reversionary bonus of ` 12 per ` 1,000 and gave the

policy holders an option to get the bonus in cash for `1,000. Total business of the company is ` 1 crore, 40% of the policyholders decide to get bonus in cash.
Prepare:

1. Valuation balance sheet as on 31.03.2014.
2. Distribution statement showing the amount due to the

policyholders. Also give journal Entries relating to reversionary bonus.

3. The following Trial balance was extracted from the books of Bharat Life Assurance Co. Ltd. as on 31 March, 2013:

Particulars	*Dr.* `	*Cr.* `
Share Capital (shares of ` 10 each)		1,60,000
Life assurance fund as on 1st April, 2012		29,72,300
Dividends paid	15,000	
Bonus to policy holders	31,500	
Premium received		1,01,500
Claims paid	1,97,000	
Commission paid	9,300	
Management expenses	32,300	
Mortgage in India	4,92,200	
Interest and dividends received		1,12,700
Agents' balances	9,300	
Freehold premises	40,000	
Investments	23,05,000	
Loan on company's policies	1,73,600	
Cash on deposit	27,000	
Cash in hand and on current A/c	7,300	
Surrenders	7,000	
	33,46,500	33,46,500

You are required to prepare the company's Revenue Account for the year ended 31st March, 2013 and its balance sheet as on that date after taking the following matters into consideration:

a) Claims admitted but not paid ` 9,300
b) Management Expenses due ` 200
c) Interest accrued `19,300
d) Premium outstanding `12,000

4. Prepare a revenue Account for fire business from the following details for the year 2013-14:

	`
Reserve for unexpected risk on 1.4.2013 @ 50%	1,80,000
Additional reserves	36,000
Estimated liability for claims intimidated on 1.4.2013	31,000

Estimated liability for claims intimidated on 31.3.2014	42,000
Claims paid	3,65,000
Legal expenses	6,000
Reinsurance recoveries	32,000
Medical expenses	4,000
Bad debts	800
Premium recovered	4,86,000
Premium on re-insurance accepted	32,000
Premium on re-insurance cede	43,000
Commission on direct business	48,000
Commission on reinsurance accepted	1,600
Commission on reinsurance cede	2,150
Expenses of management	90,000
Interest, dividend and rent	24,000
Profit on sale of investments	3,000

Create reserve on 31.12.2001 to the same extent as on 31.3.2014.

5. From the following balances of Safety Insurance Co. Ltd. as on 31 March, 2015 prepare (1) Fire Revenue A/c, (2) Marine Revenue A/c, and (3) P&L A/c.

Particulars	`	Particulars	`
Bad debts (fire)	10,000	Depreciation	70,000
Bad debts (marine)	24,000	Interest, dividend received	28,000
Auditor's fees	6,000	Difference in exchange(Cr.)	600
Director's fees	6,400	Miscellaneous receipts	10,000
Share transfer fees	1,600	Profit on sale of land	1,20,000
Bad debts recovered	2,400	Fire premium less reinsurance	12,00,000
Revenue (Fire as on 1 April,2014)	5,00,000	Management expenses(fire)	21,60,000
Revenue (Marine as on 1	16,40,000	Management expenses	
April,2014)	3,80,000	(marine)	2,90,000
Claims paid outstanding (fire)		Commission earned on	
Claims paid outstanding (marine)	7,60,000	reinsurance cede(fire)	8,00,000
Commission paid (fire)	1,80,000	Commission earned on	
Commission paid (marine)	2,16,000	reinsurance cede(marine)	60,000
Additional reserve (fire as on 1			
April,2014)	1,00,000		1,20,000

In addition to the usual reserve, additional reserve in case of fire insurance is to be increased by 5% of net premium.

6. New Insurance Co. Ltd., is doing composite insurance business. The following balances pertaining to its marine business as on 31st March, 2014 are submitted to you for preparing the Revenue A/c for the year ended on that date in the prescribed form:

	( )
Commission on re-insurance accepted	1,86,000
Commission on direct business	1,95,000
Commission on re-insurance cede	3,42,000
Depreciation	7,000
Loss on sale of motor car	12,000
General Managers' Salary	48,000
Rent	62,500
Postage, telegram and telephones	10,000
Staff salary and bonus	1,50,000
Travelling expenses	25,600
Motor expenses	85,000
Printing, Stationery and periodicals	49,000
Law charges	25,000
Electricity charges	11,000
Contribution to staff provident fund	10,900
Audit fees	4,000
Bad debts	1,200
Miscellaneous expenses	2,5000
Claims under policies paid during the year	6,53,000
Reserve for unexpired as on 1st April, 2013	13,67,000
Additional reserve for unexpired risks as on 1st April, 2013	46,000
Premium received for less re-insurances	9,90,000

(1) Gross Premium written direct in India was ` 12,23,000.

(2) No premium was written outside India and as such no business was transacted outside India during 2015-14.

(3) Total estimated liability in respect of claims due or intimated as on 1st April, 2013 and 31st March, 2014, were Rs 1,200 and Rs 6,300, respectively.

(4) The general Manager's salary pertaining to Marine Department was Rs 24,000.

(5) Make an additional reserve of 10% of the premium received in addition to the usual reserve required to be maintained as per the code of conduct in respect of unexpired risks as on 31st March, 2014.

7. The following figures are from the books of Varuna Fire Insurance Co. Ltd. at the end of their financial year ended 31st March, 2014:

	(Rs)		*(Rs)*
Fire fund	6,20,000	Share capital	6,00,000
General reserve	3,00,000	Additions al reserves	2,20,000
Investments	20,00,000	Profit and Loss A/c	50,000
Premiums	18,01,022	Re-insurance premium	75,017
Claims paid	4,01,877	Claims recovered from re-insurance	14,079
Commission on re-insurance ceded			32,011
Commission on direct business			1,99,777

Commission on re-insurance accepted	40,100
Outstanding premiums	14,865

Claims intimated but not paid (1st April, 2013)	40,000
Expenses of management	2,87,965
Audit fees	12,000
Directors' fees	12,000
Rates and taxes	3,869
Rents	45,000
Income from investments	1,00,000
Share transfer fees	2,000
Loans (Dr.)	4,00,000
Sundry creditors	15,000
Agents balances (Dr.)	1,80,000
Cash in hand	20,155
Cash at bank	1,01,487

From the above, you are required to prepare Fire Revenue Account, Profit and Loss Account, Profit and Loss Apportion Account an Balance Sheet of the Company, after taking into account the following:

(i) Income tax to be provided Rs 2,50,000

(ii) Transfer to General Reserve Rs 1,00,000

(iii) Proposed Dividend 12%

(iv) Claims intimated but not paid as on 31st March, 2014, Rs 60,000.

8 From the following balances of Hi-Fi General Insurance Co. Ltd. as on 31st March 2013, prepare

(i) Fire Revenue A/c;

(ii) Marine Revenue A/c; and

(iii)Profit & Loss A/c.

Particulars	*Rs*	*Particulars*	*Rs*

Survey expenses (fire)	10,000	Commission earned on	
Additional reserve-opening (fire)	50,000	reinsurance ceded(marine)	60,000
Commission paid (marine)	1,08,000	Commission earned on	
Commission paid (fire)	90,000	reinsurance ceded(fire)	30,000
Claims paid and outstanding		Management expenses (fire)	1,45,000
(marine)	3,80,000	Management expenses	4,00,000
Claims paid and outstanding (fire)	1,80,000	(marine)	
Fire fund-opening	2,50,000	Marine premium	10,80,000
Marine fund-opening	8,20,000	*Less:* Reinsurances	
Bad debts recovered	1,200	Fire Premium	6,00,000
Share transfer fee	800	*Less:* Reinsurances	60,000
Director’s fees	5,000	Profit on sale of land	5,000
Auditor’s fees	1,200	Miscellaneous receipts	300
Bad debts (marine)	12,000	Differences in exchange (cr.)	14,000
Bad debts (fire)	5,000	Interest, dividends, etc,	35,000
		received	
		Depreciation	

In addition to usual reserves, additional reserve in case of fire insurance is to be increased by 5% of the net premium.

9. From the following details, prepare the Revenue A/C, Profit and Loss Account and Balance sheet of Moon shine Insurance Co. Ltd. carrying on Marine Insurance business, for the year ended 31.3.2015.

	` ‘000		` ‘000
Agents balance (Dr.)	1,46,400	Share capital	15,00,000
Interest accrued but not due	8,200	Balance of marine fund	
Furniture & fixtures (cost	8,400	(1.4.2014)	7,60,000
Rs.12,600)		Unclaimed dividends	2,400
Stock of stationery	2,500	P & L a/c (Cr.)	2,40,000
Expenses of management	2,20,000	Sundry creditors	12,600
Foreign taxes & Insurance	12,300	Due to reinsurers	60,000
Outstanding premium	21,200	Premium less	12,40,000
Donations paid	8,600	reinsurance	
Advance income tax payments	62,000	Interest & Dividends	2,40,000
Sundry debtors	9,200	Transfer fees received	600
Govt. of India securities	9,20,000		
Debenture of public bodies	1,80,000		
Shares in limited companies	3,60,000		
State govt. securities	8,80,000		
Claims less re insurance	10,60,000		
Commission paid	62,400		
Cash & Bank balance	94,400		

Outstanding claims on 31.3.15 were Rs.1,40,000 thousands. Depreciation on furniture to be provided at 20% per annum.